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OVERFUNDED PENSION PLANS

JOINT HEARING

BEFORE THE

SELECT COMMITTEE ON AGING

AND THE

SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

OF THE

COMMITTEE ON EDUCATION AND LABOR HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

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OVERFUNDED PENSION PLANS

WEDNESDAY, JUNE 12, 1985

U.S. HOUSE OF REPRESENTATIVES, SELECT COMMITTEE ON AGING, AND THE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS OF THE COMMITTEE ON EDUCATION AND LABOR,

Washington, DC.

The committee and subcommittee met, pursuant to notice, at 10:15 a.m., in room 2175, Rayburn House Office Building, Hon. Edward R. Roybal (chairman of the Select Committee on Aging) and Hon. William (Bill) Clay (chairman of the Subcommittee on Labor-Management Relations) presiding.

Members present: Representatives Roybal, Pepper, Biaggi, Rinaldo, Bentley, Lightfoot, Boehlert, Saxton, Meyers, Schuette, Clay, Hayes, Dymally Fawell, Atkins, and Owens.

Staff present: Select Committee on Aging: Roger Thomas, general counsel; Anthony Knettel, professional staff and Esther Urbano, staff assistant; Kathleen Gardner-Cravedi, staff director of the Subcommittee on Health and Long-Term Care; Teresa Karamanos, research associate, Subcommittee on Human Services.

Staff present: Subcommittee on Labor-Management Relations: Frederick L. Feinstein, counsel; Russell J. Mueller, Republican legislative associate/actuary; Daniel V. Yager, Republican associate labor counsel.

OPENING STATEMENT OF CHAIRMAN WILLIAM (BILL) CLAY

Mr. CLAY. The meeting will be in order.

This morning the Subcommittee on Labor-Management Relations and the Select Committee on Aging will hold a joint oversight hearing on overfunded pension plans.

In the past, Congress has spent a great deal of time focusing on the problem of underfunded plans. Recently, however, termination of overfunded plans, resulting in a reversion of the so-called excess assets to the sponsoring employer, has become a growing problem. Pension plans have become an unfortunate pawn in corporate takeover wars. Meanwhile, the purpose for which the plans were established, to provide retirement security, is all but forgotten.

This is the first hearing this subcommittee has held on this subject, although the select committee, under the distinguished leadership of my colleague, Chairman Ed Roybal, has spent a great deal of time studying the issue.

Today we will examine the continuing trend toward termination of overfunded defined plans, focusing on why plans have become overfunded, why companies with overfunded plans terminate them, the extent to which companies that terminate plans then reestablish successor plans, and whether plan participants and retirees are harmed by these transactions.

Our witnesses will include participants whose plans have terminated, commentators who have researched and written on this issue, and representatives of both organized labor and the business community.

In addition, we will hear from the administration. Over a year ago, in a rare instance of interagency cooperation, a set of guidelines to deal with overfunded plan terminations was issued by the Department of Labor and Treasury, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation. Those guidelines are currently being challenged in the courts in two cases in which the basis for the administration's authority to issue the guidelines has been called into question.

I know that some of my colleagues, including Chairman Roybal, have already concluded that the problems of plan termination and reversions are serious enough to warrant remedial legislation. They have also concluded that the administration's guidelines, even if upheld by the courts, are inadequate to deal with the problems.

I am very troubled about the increasing role that excess pension assets are playing in takeover decisions. Certainly United Airlines' decision the other day to terminate its overfunded pension plans and recover nearly $1 billion in excess assets for the expressed reason of making the company less attractive as a takeover target concerns me greatly. As a relative newcomer on this issue, I start with only one preconceived notion: This problem is incredibly complicated, and there are few simple solutions. Therefore, I am here to learn. This oversight hearing is designed to lay out all sides of the issue so that the members of the Subcommittee and the select committee will be able to draw informed conclusions about the need to reevaluate the current ERISA and Internal Revenue Code rules governing overfunded plan terminations.

Because the time we have today is limited, we were not able to accommodate all who wished to testify. The hearing record will remain open for 2 weeks. So we encourage you to submit written statements for the record.

Chairman Roybal.

OPENING STATEMENT OF CHAIRMAN EDWARD R. ROYBAL

Mr. ROYBAL. Thank you, Mr. Chairman.

The purpose of today's joint hearing is to examine the explosion in the number of recent overfunded defined benefit pension plan terminations. This Monday United Airlines announced its plan to recapture almost $1 billion from its pension plan, making the United Airlines' proposal the largest recapture of assets to date. These terminations are often motivated by an employer's desire to recapture excess pension plan assets and use them for other corporate purposes. Any pension plan termination puts the retirement security of plan participants at risk. Yet, current Federal law permits employers to unilaterally terminate plans, as United Airlines is doing, despite the expectations of employers and retirees.

The unfortunate result is that many pension plans which are granted significant tax advantages by Congress are now becoming capital accumulations. They are just devices for cash-hungry companies. Surely this result was not envisioned by the drafters of the Employee Retirement Income Security Act.

Thus far, the administration's response has proved to be inadequate, encouraging rather than discouraging overfunded terminations like United Airlines. The joint agency guidelines on terminations are an attempt to permit employers to recapture excess plan assets while retaining defined benefit plans for their employees.

While the guidelines serve the purposes of employers, the limitation of the guidelines under current law prevents the agencies which regulate private pensions from fully protecting the interests of employees and retirees.

The legality of the guidelines is current under attack in two pending lawsuits. Even the minimal protection given by the guidelines may soon collapse like a house of cards.

With this in mind, last Thursday I introduced with myself and 15 cosponsors a substantially revised and improved version of legislation offered for comment last year. The bill, H.R. 2701, represents what I believe is a reasonable and necessary solution to protect the rights and expectations of employees and retirees.

Without objection, I will submit the balance of my statement for the record.

[The balance of Chairman Roybal's statement follows:]

Today's hearing gives us an opportunity to examine the trend of "overfunded" plan terminations in detail. We will consider H.R. 2701 as well as other proposals intended to address this problem. I am committed to finding a bipartisan approach which will protect the interests of employees and retirees—maintaining the integrity of the private pension system—while preserving the viability of defined benefits pension plans for corporate plan sponsors.

I. MY COMMITMENT TO EMPLOYEES AND RETIREES

Today the private pension system covers approximately 35 million American workers and represents trust fund assets estimated at $1 trillion. It plays a crucial role as a source of retirement income for millions of present and future retirees. Yet the burgeoning trend of "overfunded" defined benefit pension plan terminations has already begun to destabilize the private pension system and undermine the public's confidence in the system's ability to provide them with reliable, secure retirement income to match their expectations.

Three years ago, the House Select Committee on Aging began its investigation of the first of what has become a tidal wave of plan terminations designed to permit employers to recapture "excess" plan assets after plan liabilities are satisfied. Members of the Committee have exhorted the agencies which are charged with the enforcement of ERISA—Treasury, DoL, IRS and PBGC—to collectively take a policy position which would discourage any expansion in the use of terminated pension plans as corporate financing vehicles.

The dearth of effective agency policy has resulted in the following shameful statistics:

1. Since January 1, 1980 to the present PBGC has or is in the process of approving the termination of nearly 700 defined benefit pension plans, each with a reversion of $1 million or more.
2. These completed and pendiung terminations represent in excess of $6.6 billion in tax-deductible plan contributions and tax-deferred returns on trust fund investments, originally intended to fund future pension benefit accruals, which will now be utilized for other corporate purposes. This figure does not include the $962 million to be recaptured in the proposed United Airlines reversion.
3. About 850,000 plan participants already face the risk of a reduction in their expected retirement benefits as a result of these terminations.

In the past, defenders of these practices in the Administration as well as the private pension community have argued that such terminations represent only a fraction of the entire private pension system. You may hear this argument again today. They suggest that not enough employees and retirees are effected to be concerned.

I reject this callous excuse for inaction. Every one of the 850,000 plan participants potentially affected by these practices has rights and interests deserving of the Administration's most vigorous protection. And the number of employees and retirees at risk is increasing rapidly. Half of the total "overfunded" terminations and resultant reversions since 1980 occurred in 1984 alone. I have seen no evidence to indicate that the furious storm of plan terminations is likely to subside in the foreseeable future.

The record to date has demonstrated the numerous ways in which "overfunded" plan terminations undermine the retirement income security of present and future retirees. The economic incentives favoring plan termination, created by the prevailing interpretation of current law, are clearly contrary to the fundamental goals of ERISA and the private pension system. Having already proved itself unable or unwilling to restore stability to the private pension system, it is time for the Administration to acknowledge the leadership of Congress in the fight to protect the integrity of the pension promise to American workers.

II. WHERE DO "EXCESS" ASSETS COME FROM

The primary source of "excess" plan assets which employers recapture at termination is ERISA's own minimum funding rules. ERISA requires employers to find their pension obligations in advance to ensure that when an employee retires, the plan will have sufficient assets to pay his or her benefits. These future benefit obligations are calculated taking into account subsequent salary increases and additional years of service with the employer. Thus a plan is said to funded on an "ongoing concern" basis.

However, when an employer terminates a pension plan, it is only legally obligated to pay pension benefits based on salary and service accured up to the date of the termination. An individual's benefit is thus said to be calculated on a "termination" basis. Because a plan is funded on an "ongoing concern" basis but benefits at termination are calculated on a "termination" basis, the majority of defined benefit pension plans which are funded in accordance with ERISA's minimum funding rules will, when terminated, have assets in excess of plan liabilities. The benefit formula and funding method chosen by the employer also effect the relationship of the plan's assets in a given year to its termination liabilities.

Another factor contributes to the difference between total plan assets and termination liabilities. Many employers use conservative investment return assumptions when determining their annual pension plan contributions. If the plan's actual investment experience exceeds expectations, the plan will begin to accumulate assets in excess of ongoing plan liabilities—what might be considered a true "surplus". However, in the past many employers found this situation desirable. It protects them against poor investment performance in subsequent years. Further, under current law employers are not permitted to pre-fund future ad hoc benefit increases or COLAs. By funding the plan conservatively, employers can grant such ad hoc increases without jeopardizing the plan's funding status. It is only within the past few years that employer's have began to mortgage the future of their retirement benefit programs by recapturing "excess" assets from their plans.

III. WHY DO EMPLOYERS TERMINATE THEIR "OVERFUNDED" PLANS

Although the drafters of ERISA probably conceived of pension plan terminations as extraordinary events in the course of an employer's provision of retirement income to its employees, resulting principally from business hardships, the subsequent experience of the last decade has been quite different. It sometimes seems as though employers terminate their plans and replace them with successor plans because it is easier to do so than amend the old plan.

Some of the recent "overfunded" pension plan terminations appear to have resulted from factors related to plan cost, dissatisfaction with plan design, or corporate reorganization. All of these reasons for termination are appropriate, incidental to the existence of "excess" assets in the plan, and ought not to be hindered by public policy. But many such terminations were clearly motivated by the express desire to recapture "excess" assets from the plan. These reversions have been put to a variety of uses: writing-down debts incurred during takeover battles or resulting from capital investments; improving the corporation's "bottom line" in years of otherwise undistinguished profits; carrying the corporation through a short-term cash-flow crisis. Indeed, some employers seem to seek reversions simply because the cost of capital recaptured from their pension plan is lower than that borrowed from an institutional lender.

IV. WHY ARE "OVERFUNDED" TERMINATIONS A PROBLEM

The specific use of such reversions is not as significant as the fact that under these circumstances employers are effectively using their tax-favored pension plans as capital accumulation devices and corporate financing tools, often without adequately protecting the interests of plan participants. In general, any pension plan termination puts the retirement security of employees and retirees at risk, and there must be considerable care exercised in the design of a replacement plan to ensure that plan participants do not suffer a tangible loss as a result. Unfortunately, many employers have failed to exercise this requisite degree of care.

Although a terminated plan is required to vest accrued benefits and safisfy all plan liabilities accrued up to the date of termination, current law does ot require the successor plan (if any) to retain the same benefit type or formula as the terminated plan. Thus large numbers of employees have suddenly found themselves covered by defined contribution arrangements which saddle them with the risk of plan investment performance. Others find themselves covered by a new defined benefit plan which has a less generous benefit formula than the terminated plan. Some successor plans have not provided credit for past service under the old plan, forcing employees to remain employed for up to ten years to vest in benefits under the new plan as if they were new hires.

Even in cases where comparable benefits are available after a plan termination, plan participants are still tangibly affected by terminations premised on asset reversions. Removal of the "excess" assets means the employer will be faced with increased future plan funding costs if the prior benefit levels are maintained. This, coupled with the fact that the excess is no longer available to protect against poor plan investment performance, means that at best fewer ad hoc benefit increases and COLAs are likely to be granted to emplyees and retirees in subsequent years. At worst, the plan has suffered an increased exposure to the risk of underfunding and termination with insufficient assets to cover liabilities in the event of an employer's future business difficulties.

V. THE PROBLEM WILL NOT GO AWAY

Opponents of the development of new Federal pension policies to protect employees and retirees from the detrimental impact of "overfunded" plan terminations have argued that these corporate practices are only a temporary phenomenon, caused by a confluence of economic factors. They insist that, like a tornado, the economic conditions that have made plan terminations financially desirable will soon pass by.

While recent high interest rates and above average investment returns have to some degree increased the size of particular reversions, it is misleading to suggest that "excess" assets, which have their foundation in plan funding methods, will disappear when market conditions return to historically typical levels. Their argument also does not take into account the substantial tax advantages employers receive by effectively delaying taxation of earnings contributed to a pension plan until later years when the assets are recaptured after a period of tax-exempt growth.

Even if we assume that reversion behavior is largely the result of cyclic economic conditions, such an assumption does not justify the failure to formulate a new and responsive policy. If the problem subsided with changes in the economy, it would be likely to return when conditions again reached cyclic highs. Further, if future investment return does not match experience during the past few years, than the experience gains resulting from these "atypical economic conditions" will be needed to offset future experience losses in order to maintain benefit levels as economic conditions reach cyclical lows

VI. THE ADMINISTRATION RESPONSE FAILS TO ADEQUATELY PROTECT EMPLOYEES, RETIREES OR EMPLOYERS

Although the Administration's joint agency Guidelines have been touted as fully protecting plan participants, there are in fact obvious and serious gaps in the "protection" they provide.

The Guidelines have encouraged (rather than discouraged) additional plan terminations, and done nothing to eliminate current incentives to terminate "overfunded" plans. They do not require past service credit or the maintenance of a comparably generous benefit formula in a successor or spin-off plan. Further, an employee's benefts are only protected up to a PBGC maximum guaranteed benefit level. The Guidelines do not require that a "cushion" of assets be left in an ongoing plan to insulate employees from the risk that the spin-off or replacement plan will eventually become underfunded such that plan participants lose the difference between their accured benefits and the PBGC maximum benefit guaranty amount.

Similarly, the Guidelines place no restriction whatever on the increasingly frequent use of employee stock ownership plans (ESOPs) as replacements for defined benefit plans during corporate takeover battles. ESOPs are plans which invest trust fund assets primarily in a non-diversified portfolio of the employer's own stock. If the employer's business subsequently falters, employees could find themselves without a job and dependent on a retirement plan invested in significantly less valuable stock. Despite these risks, employers such as Phillips Petroleum have recently replaced pension plans with ESOPs as part of a corporate strategy to buy back corporate stock and entrench management.

It should be noted that the Guidelines do not adequately protect employers either. United Airlines represents the most spectacular of a long line of terminations (beginning with Haper & Row in 1982) motivated by the fear that the availability of an asset reversion from their pension plan would make them an irresistible takeover target. It is ludicrous that Federal policy should put employers in a position where they feel the necessity to terminate pension plans (thereby jeopardizing retirement benefits) just to avoid hostile takeovers.

Perhaps the fatal flaw of the Guidelines is their tenuous statutory foundation. The IRS's own internal memoranda point out several provisions of the Guidelines which have no apparent basis in current law. Should pending law suits challenging the validity and enforceability of the Guidelines succeed, employers will rush to the wide open window in an attempt to recapture "excess" assets from pension plans before Congress can slam it shut.

VII. IS REMEDIAL LEGISLATION NEEDED

For all of the reasons discussed above, I have come to the conclusion that legislation is absolutely necessary to bring the rampant "overfunded" termination trend under control before any more damage is done. The possibly imminent demise of the Guidelines at the hands of a Federal court magnifies this urgent need. It is time for the ostriches to pull their heads out of the ground and stop pretending that the problem is insignificant or that it will go away if we ignore it long enough. The solution must not be a piecemeal approach, but one that addresses the full range of adverse results of terminations motivated by the availability of "excess" assets.

Defenders of corporate termination behavior insist that employers bear the risk of poor plan investment performance, and thus must be permitted to recapture "excess" assets without restraint when a plan terminates. This assertion ignores the fact that once an employer's plan has reached a level of adequate funding, the employer can insulate itself from much of its downside risk by a variety of actions, including a reduction or freeze of future benefit accruals. Thus under current law an employer has a virtually unlimited potential to recapture experience gains while it has various tools to limit its exposure to the plan's financial risks.

There is in fact no empirical evidence based on this country's own past experience to support the claim by the Administration and other opponents of comprehensive legislation that reasonable restrictions on the ability of employers to recapture "excess" assets under proscribed circumstances will cause employers to underfund their pension plans, or abandon their defined benefit plans altogether. It is time that "overfunded" pension plans ceased being corporate "tax shelters," as a representative of Mobil Corporation recently characterized the company's pension plan, and returned to being retirement trusts for the exclusive benefit of plan participants and beneficiaries.

VIII. CONCLUSION; MY COMMITMENT TO A BIPARTISAN SOLUTION

My experience during the last two years had led to the conviction that ultimately legislation must be enacted to restore equilibrium to the private pension system. The introduction of H.R. 2701 last wek was intended to give Congress a vehicle to begin the development of a bipartisan response to the current deplorable state of Federal pension policy regarding asset reversions. Some have criticized the introduction of such legislation, arguing that it will encourage employers to terminate their plans. The testimony we will hear today should leave no doubt that current economic incentives favoring plan terminations are already so great that employers need no encouragement to terminate their defined benefit plans.

Mr. ROYBAL. I do want to thank the witnesses in advance for coming here this morning to share their views. Today's hearing gives us an opportunity to examine the trend of overfunded plan terminations in detail. We will consider H.R. 2701 as well as other proposals intended to address this problem.

I am committed to finding a bipartisan approach which will protect the interests of employees and retirees, maintaining the integrity of the private pension system, while preserving at the same time the visibility of defined benefit pension plans for corporate plan sponsors.

I wish to thank you, Mr. Chairman.

Mr. CLAY. Thank you.

Mr. Fawell.

Mr. FAWELL. Thank you, Mr. Chairman.

Congresswoman Roukema is not able to attend these meetings. She has asked that I ask for the unanimous consent of this joint meeting of the committees that her statement be entered of record, and I do so.

Mr. CLAY. Without objection, it is so ordered.

[Statement of Representative Marge Roukema follows:]

PREPARED STATEMENT OF REPRESENTATIVE MARGE ROUKEMA

Mr. Chairman, as the ranking minority member of this subcommittee, I endorse your decision to hold these hearings, which we have discussed on many occasions in the past. They are timely and I appreciate the opportunity to focus upon this most critical issue confronting this nation's voluntary private pension system—that is, the termination of overfunded pension plans of the defined benefit variety.

I am pleased, Mr. Chairman, that our subcommittee will also address the other major ERISA Title IV issue—the rising cost of the termination of underfunded single employer pension plans. After studying the PBGC single employer deficit issue over the past two Congresses, I am sure it is your desire, Mr. Chairman, as it is mine, that the Single Employer Pension Plan Amendments we have agreed to sponsor, coupled with similar legislative recommendations we expect to receive soon from the Administration, will serve as the legislative springboard needed to help assure the solvency and long-term self-financing nature of the single employer pension plan termination insurance program under Title IV of ERISA.

The hearing today raises important questions about the very nature of our voluntary pension system and the role defined benefit plans can and should play in enhancing the retirement income security of our nation's elderly workers and their families.

The precipitous action taken two days ago by United Airlines [UAL, Inc.] in announcing the termination of its pension plans, which will result in the reversion to the company of nearly $1 billion, adds to the climate of alarm in this pension debate. Clearly, the seriousness of this matter mandates a penetrating analysis of the implications of this case.

While not prejudging what we will learn, I anticipate that today's proceedings will provide us with the viewpoints from all sides and establish a clear and coherent record regarding the termination of plans and the reversion of excess assets to employers' use.

A number of concerns and questions have been raised in connection with the nearly $4 billion in asset reversions that have taken place since 1979 under approximately 600 plan terminations.

First, what are the causes behind this major economic phenomenon? To what extent has corporate takeover activity accelerated the termination of defined benefit pension plans? What actions have taken place and what changes in conditions, if any, can be anticipated which will alter the present trend in plan termination activity? What implication does the present trend have on the premium base and the cost of the single employer termination insurance program? Do all parties have the same understanding of the state and administration of the tax and ERISA law in this area? Finally, should present law and/or its current administration be changed? If so, what would be the likely effect on the willingness of American business to maintain defined-benefit plans if the regulation of such plans, as compared with defined contribution plans, is increased?

Missteps taken by the Congress in the ERISA Title IV area are not easily corrected, as we are often reminded in connection with the 1980 Multiemployer Pension Plan Amendments Act. Therefore I would encourage others not testifying here today to submit their analyses and positions in order that the record be made complete.

Mr. Chairman, I look forward in the coming months to working with you on a bipartisan basis to make the necessary decisions to bring ERISA Title IV, and its other titles, into conformance with the national retirement income policy we both seek.

Mr. CLAY. Senator Pepper, did you have a statement?

STATEMENT OF REPRESENTATIVE CLAUDE PEPPER

Mr. PEPPER. Chairman Clay and Chairman Roybal, my fellow members of the committee, ladies and gentlemen, I want to commend my distinguished colleague, the Honorable Edward Roybal, Chairman of the House Select Committee on Aging, and the chairman of the subcommittee, the Honorable William Clay, for convening this very timely and important hearing involving pension reform in our country, an issue of vital importance to millions of workers and retired persons who rely on their pension benefits for their future retirement security.

Nothing more dramatically typifies the problem facing numerous people in America with pension plans than United Airlines' recent decision to terminate its pension plan to recapture nearly $1 billion in excess assets, not to be used for pension benefits but to be placed in a trust for corporate expansion. The decision by United Airlines to transfer nearly $1 billion from the future retirement income of its employees into a fund for corporate development should be considered almost a criminal offense. I cannot think of a more contemptible act than a conspiracy of the part of those entrusted with the management of pension funds than to convert those assets for their own interests, assets upon which about 50 percent of all working Americans depend for their future security.

During my service on the House Select Committee on Aging, I found that, where pension plans have been allowed to become overfunded, such as in the instance of United Airlines' pension plan, the managers of these plans have been tempted to treat them like their own personal piggybanks, greedily breaking into them and raiding them on a rainy day of their own financial difficulty, arbitrarily terminating the pension system and taking over the assets.

Today I am calling upon United Airlines to reconsider its decision and to serve as a model for others in addressing this pension reform problem. The United Airlines case is the largest in a long series of corporate terminations of employee pension plans. From 1979 to the present, nearly 600 companies have tampered with the pension plans of their employees at a cost of over $5 billion to American workers and retirees.

In my congressional office in Miami there was a certain lady, the wife of a captain of Braniff Airlines. She, thinking her husband had an adequate retirement program, after his retirement, left the job that she had with me and retired to inactivity. In a little while she came back and wanted her job back. Unfortunately, I had already filled the position, and I didn't have another. That is a typical case of where people rely upon their pensions. To be denied those pensions has a very serious effect upon their way of life.

Today's hearings will serve to outline the abuse which has been allowed to persist in the management of this Nation's pension trust funds. I cannot believe that Congress intended that employees and their families should have to face the demise of that sacred promise of a pension in such an unexpected and unseemly way. I think it may be time for Congress to enact legislation to ensure the continued integrity of the pension promise and allow workers nearing retirement to continue their participation in a pension plan without discrimination of the basis of their age.

Incidentally, they tell me that only some 20-odd percent of the people in the United States who retire have a decent pension fund upon which to retire. Sometimes we say Social Security is not intended to be the sole source of one's income upon retirement. But if they don't have any other, they may have to make it or accept it as the sole source of their income.

So, I join my distinguished chairman, Representative Roybal, in sponsoring legislation which would accomplish this objective.

Again, I commend my colleagues for addressing this issue. I look forward to hearing today's important testimony.

Thank you, Mr. Chairman.

Mr. CLAY. Thank you, Senator.

I now recognize the ranking member of the Select Committee on Aging, Mr. Rinaldo.

STATEMENT OF REPRESENTATIVE MATTHEW J. RINALDO

Mr. RINALDO. Thank you very much, Mr. Chairman.

I want to begin by commending my colleagues, Congressman Royal and Congressman Clay, for calling this hearing today to examine corporate use of employee pension plans and its effect on America's workers.

Since the Aging Committee last examined this issue in 1983, the problem has worsened. From 1979 through January 1985, over 500 corporations terminated defined pension plans with an alleged excess of funds above that needed to pay retirement benefits. According to the Pension Benefit Guaranty Corporation, over half of these terminations, or 284, occurred in 1984 alone. Obviously, some terminations are justified. But many employers seem to be caught up in the merger mania now sweeping the country. They are grabbing pension assets to either fend off or initiate corporate takeovers. Others use them to inflate earnings or prop up existing management.

These raids often leave workers under new plans with greatly reduced benefits and increased financial risk. At times, workers have been left with no plan at all. It is unfortunate that some firms, in effect, view employees' pension assets as little more than cookie jars to be invaded whenever management feels hunger pangs for quick cash.

In my own home State of New Jersey, nearly two dozen corporations have tapped pension assets worth $700 million. They have done this through plan terminations, or through contribution of real estate, securities, or other assets of uncertain value to existing plans in lieu of cash.

Mr. Chairman, the retirement future of this country's working men and women is in jeopardy. Unless swift and effective action is taken, the promise of a secure old age for many of today's employees will be a hollow one.

Although the administration has made some attempts to deal with these abuses, its actions seem to have been ineffective. The time has come to reexamine the Employee Retirement Income Security Act to discourage corporations from changing the rules from workers in midstream and reneging on pension commitments.

I say this, and I am speaking about a minority of employers, obviously, but I think it is our duty and our sworn responsibility to protect the rights and expectations of millions of employees. They must not be compromised.

Again, I want to applaud your leadership and look forward to hearing from our witnesses. Thank you.

Mr. CLAY. Thank you.

Mr. Biaggi.

STATEMENT OF REPRESENATIVE MARIO BIAGGI

Mr. BIAGGI. Thank you, Mr. Chairman.

Ten years ago we passed ERISA in response to scores of horror stories from pensioners who had lost a lifetime of benefits when companies terminated their plans without fear of reprisal. Today, even with the protections of ERISA, we are finding a serious and perhaps fatal flaw in its provisions. We see that, despite the fact that we have protected workers from completely losing their pensions under ERISA, we still see pension assets being used for nonbenefit purposes. This results in not only potential cuts in benefits for these workers, but it also erodes confidence in the very same system we intended to protect when we adopted this landmark pension reform law a decade ago.

We cannot allow employees to be placed in double jeopardy, whereby on one hand we tell them that the Federal Government will protect their pensions for retirement and on the other hand tell them that the healthiest of these plans are potential targets for benefit raids and reductions. We owe it to future generations of workers to act swiftly to avert any backdoor drain on their retirement income.

I look forward to today's testimony and especially the response from the administration, which is charged with the enforcement of pension plan protection.

Mr. CLAY. Thank you.

Hon. Mary Rose Oakar and Hon. John Paul Hammerschmidt have submitted statements for the record. Without objection, they will be placed in the record at this point.

[The statements of Ms. Oakar and Mr. Hammerschmidt follow:]

PREPARED STATEMENT OF CONGRESSWOMAN MARY ROSE OAKAR

Chairman Roybal and Chairman Clay, the issue of pension terminations is a serious one in our Nation and has had a particularly adverse effect on Ohio families. Your leadership and persistence in solving this problem is commendable. I sincerely hope that the full Committee on Education and Labor will give this problem priority during the remainder of this Congress and pass reform legislation.

The number of terminations and reversions are astounding. From 1979 to 1983, 284 plans with over $1 million assets were terminated. An additional 279 plans applied for termination in 1984. Reversions to employers during this same period totaled $2.1 billion. Most importantly, 669,000 workers have been hurt by these limited terminations.

To give you an indication as to how pension terminations have affected my constituents in the greater metropolitan Cleveland area, I would like to share with you some statistics. Since 1979, 38 major corporations with subsidiaries in the metropolitan Cleveland area have terminated pension plans. Corporations headquartered in the Cleveland area that have terminated plans total 16. And, as of last month, 15 national companies and 11 Cleveland firms have applied to terminate pension programs. Admittedly, some corporations have valid reasons for terminating pension plans and do, in some instances, reestablish plans later on in time. I hope the committee will hear their justifications.

The limited research conducted on this subject suggests that businesses terminate pensions to recapture assets. Business hardships, corporate mergers, takeovers, or defensive tactics to protect against takeovers have prompted employers to cut off pension plans in an effort to survive.

A firm in serious financial difficulty may terminate its plan so that no additional liabilities accrue. Furthermore, if the plan has excess assets, the firm may want the excess to refinance its debt or use the funds to keep the firm operational.

Excess assets in pension plans have played a key role in financing mergers and takeovers in recent years as well. In many instances, it is easier and much cheaper to recoup excess funds from a pension plan than it is to raise the necessary funds in the capital markets. The most notable example, I understand, was the Occidental Petroleum takeover of Cities Service in 1983. The merged company terminated 6 pension plans and recouped over $360 million in excess assets. This, in turn, paid for a significant share of the cost of the takeover.

Central to the issue of pension terminations is the notion of contractual agreements. Is there a bond between workers and employers which should not be broken? I would say, resoundingly, yes. Employers have an obligation to ensure that the pension they offer workers will be there, in full, for retirement. "Pensions are not gratuities," as Senator Harrison Williams stated during debate of ERISA. Workers pay for these benefits and deserve full payments after they have left the labor force.

Unfortunately, the Reagan administration's policy adopted last year favors the corporate chiefs. While the Reagan Administration argues that the participants' rights are fully protected and that the voluntary nature of the private pension system is also maintained by requiring a plan to purchase annuity contracts covering all accrued benefits before assets may revert to the employer, it also supports the idea that the decision to terminate a plan is a business decision, not a fiduciary one. Therefore, the trustees of a pension plan do not have to demonstrate that the termination is in the best interests of the participants.

I take exception with the administration's policy for several reasons:

1. First and foremost, participants may realize a significant loss. Workers could assume that a plan would continue indefinitely, as long as the sponsoring firm remains financially viable. When a pension plan is terminated in mid-stream, however, an employee's losses can be great. Even though accrued benefits are protected upon a plan's termination, they are based on current salary and years of service, not on what the employee could reasonably expect upon normal retirement. The Department of Labor estimates that participants in terminated plans average 45 cents for every dollar that they might have received had the plan continued.

2. Reversions violate the spirit, if not the letter, of ERISA. Barring financial problems for a firm, the law assumes an indefinite existence for a pension plan. In the long-run, excess assets are atypical. In most cases, the aging workforce or a decline in the market will eliminate the excess.

3. Terminations increase the Government's potential liability. The PBGC insures unfunded liabilities in terminated plans. Excess assets reduce the Government's risk.

Finally, Chairman Roybal and Clay, as I drove to work yesterday morning, I learned that United Airlines has terminated its pension plan, in the amount of $1 billion, to avoid a takeover. The company has said it intends to establish a new plan, but if the new plan does not recognize past service, the loss to United employees could be over $400 million.

It appears obvious that pension terminations is not just a passing phase. They create serious ramifications on our economy and the security of our work force.

Greater policing, as outlined in your legislation, is necessary. I am certain that today's witnesses will underscore by sentiments.

Thank you.

PREPARED STATEMENT BY REPRESENTATIVE JOHN PAUL HAMMERSCHMIDT

Mr. Chairman, thank you for calling this hearing on pension plan terminations. This issue is especially timely, in light of the proposed budget, which requires those of us in Congress to carefully consider cost effective ways of seeing that needed programs and services are continued, while still reducing the deficit.

I think that most of us here today would agree that Social Security was never meant to be the sole source of a person's retirement income, but rather, the base upon which most people begin their retirement planning. Recognizing this, many working persons have contributed to pension funds to increase their income in their retirement years. Now, with many companies dropping pension plans, those very persons who had the opportunity and foresight to save for their retirement by contributing to company pension programs are being penalized by receiving lesser benefits than they originally were told they could expect to receive.

Over the past five years, there has been a growing trend away from dependence on Federal pension plans and Social Security for providing retirement benefits, and a movement toward investment in private plans and personal savings. This trend of shifting finacial resources from the public to the private sector is fiscally sound for both the Government and for older persons, and is why this hearing is so important. If Congress is to encourage continued reliance on private sources of retirement investment, we must see to it that these sources are stable.

The continued well-being and security of millions of retirees, employees, and their dependents are directly affected by the quality of all retirement programs, including Social Security, Federal and State pension plans, private pension plans, and individual retirement savings. As the population aged 65 and over continues to increase, the demands on these components of the retirement income system will increase. Economists have projected that the private pension system will play a major role in helping to meet the economic needs of this aging population.

I'm glad that we will have the opportunity today to examine the implications that overfunded benefit pension plan terminations have on older persons. I appreciate having the opportunity to be here today and look forward to the testimony of our distinguished witnesses. Thank you, Mr. Chairman.

Mr. **CLAY**. Our first witness today is the distinguished gentleman from Ohio, Senator Howard Metzenbaum. We welcome you to the committee, Senator. Without objection, your entire statement will be included in the record. You may proceed as you so desire.

STATEMENT OF HON. HOWARD M. METZENBAUM, A SENATOR FROM THE STATE OF OHIO

Senator **METZENBAUM**. Thank you, Chairman Clay and Chairman Roybal.

I also want to indicate my respect for the fact that there is such a good turnout of the committees today. It is an interesting fact of life that, when I addressed this issue about a year and a half ago, you could hardly get a ripple on the water. Congressman Roybal introduced legislation, and I know he experienced the same kind of reaction that I did. I think the presence of so many here today and the fact that so much of your committee is present is an indication of the concern that so many in this country are having about what is taking place.

It is a fact that when ERISA was first enacted, it was intended to insure adequate funding for pension plans, to provide for vested pension benefits and to hold pension plan administrator to the highest fiduciary standard. Now, there is no question ERISA had a positive effect. Important improvements have been made in the pension system. But today we recognize that there are serious new problems, as these funds are being taken by corporations for no earthly reason.

Why is this happening? Is it because the plans are financially unhealthy? No; that's not the reason. Are the companies experiencing economic difficulties? No; that's not the reason. We are talking about some of the Nation's most healthy pension plans, most of which are sponsored by solid profitable companies.

We have got to take a look at what the law is and why it has permitted this to occur. The law expressly states that pension funds are to be used for the exclusive benefit of participants. But with the connivance—and that is a sad commentary—with the connivance of the Federal agencies entrusted with the responsibility of enforcing our pension laws, they are being used to finance acquisitions, to defend against hostile takeovers, to fund leveraged buyouts, and a host of other activities that are certainly not for the exclusive benefit of plan participants, which is what the law expressly states the pension plans are to be used for.

We know about the United Airlines situation, $962 million to be removed from its plan. The company claims that it is terminating its plan in order to purchase additional aircraft. It is a rather interesting comment, a fact of life, that, when it made that announcement, almost all of its aircraft was grounded. I am happy to learn this morning that, as of ten o'clock, I think, there has been an announcement made that the strike has been settled. I think all of us find satisfaction and gratification in knowing that, and we commend the parties for working that out. But certainly, when they made the announcement about terminating their pension plan, it was sort of a pressure mechanism on the union and the employees.

The company also says it wants to prevent a hostile takeover. There are no indications of such a move against United. That is like saying that every company in the country might be subjected to a hostile takeover. But there is nothing hypothetical or nothing conjectural about United's plan to take $962 million out of the fund and put it in their own coffers.

We have to take a look at some of these. A&P Co., that was a wonderful deal. For $70 million, a German company acquired control of that corporation, and they immediately terminated the pension plan and removed $273 million; paid $70 and removed $273 million and put it in the corporation.

Raymond International recouped $30 million to finance a leveraged buyout. According to its former senior vice president and board of directors member it left more than half of its retirees living below the poverty line. That didn't come from a disgruntled employee. It came from the former senior vice president and a former member of the board of directors.

Amex, Celanese, Lane Bryant, Occidental Petroleum—they took out $375 million when they took over Cities Service—Getty, Washington Star, a very interesting case there. When Time Magazine bought it, there was a clause in the pension plan that said it could not be terminated. But the lawyers had failed to take care of that particular clause in the contract that said that it could be amended. So, they amended it so that it could be terminated, which was pretty clever on the lawyers' part but not very good for the employees who were left high and dry.

There is Harper and Row, so many others. Corporation after corporation is literally milking their pension funds, literally stealing the retirement security of millions of American workers and retirees. For the major corporations of this country, these terminations are nothing more or less than a financial bonanza. But for the working men and women of this country, the impact is truly devastating.

According to the Department of Labor's own staff, the cost of termination to workers runs as high as 45 cents on every promised pension dollar. Terminations deprive retirees of any hope of receiving future cost of living increases. The argument is made that we will buy the retirees an annuity, but the reality of life is that, when the fund has the money, that it has been a practice of most funds to increase on an inflationary basis the retirement benefits of their retirees. When you buy the annuity, there is no inflation adjustment made.

Employers are routinely breaking promises to distribute pension surpluses to their employees.

Pension fund terminations hurt the elderly and the older worker. They are not able to help themselves. These are hard-working people. They played by the rules, and they have made the corporations who are terminating the plans on them. What they thought they had was a federally protected right for retirement income, then they wake up to realize that they are the victims of hollow promises.

I think the time has come to provide some protection. So, you would think that the Federal Government might be that protective force. Where is the administration?

There are three agencies that should be concerned with this issue. The Department of Labor should be speaking out for the working people of this country, but it is as silent as the Rock of Gibraltar. The Pension Benefit Guaranty Corporation's concern—and this is a sad commentary—their concern is best stated by a December 1983 memorandum from its former executive director, Edwin Jones, to former Secretary Donovan in which the PBGC concluded that, quote: "There is very little, if any, legal basis for permitting certain terminations. However, from a practical point of view"—said he—"it can be contended that it is better to allow leeway for employers in this area to recover excess assets"—why? Listen—"because the PBGC may lose premium revenue."

What he was saying is, who cares about the workers? Who cares about the funds? Who cares about the rights of the participants? I'm worried about getting those PBGC premiums.

That, to me, was irresponsible and maybe went as far as being unethical as well and certainly less than commendable for a public official.

Then there is another agency, the IRS. Now, to their credit they tried to act responsibly. They were moving in the right direction with respect to the terminations and the whole question of whether they were legal or illegal and coming down on the side of illegality. But then a new hand moved in over them and gave them the message. And that was the Cabinet Counsel. The Cabinet Counsel put the pressure on and, like good soldiers, they saluted; and they rolled over and played dead.

Mr. Chairman, when the administration did act, it made a horrible situation even worse. The only thing this administration has done to date is to issue guidelines that permit so-called spin-off terminations and termination reestablishments. Now, in a spin-off termination an existing pension plan is divided into two plans, one for active workers and one for retirees. The employer then terminates the one for the retirees. He buys them annuities and recovers the excess assets.

In a termination reestablishment, an employer terminates an overfunded plan, removes the excess assets, and then commences a new plan similar to the one just terminated.

How effective are these guidelines in protecting the participants? Not very.

According to a story in Pension and Investment Age, April 29, 1985, which I would point out to this committee has done a superb job in explaining this entire issue to its readers, and I also might say, coming down on the right side of the issue. Said they: "a pension attorney who led an ad hoc group of lawyers seeking to allow the new technique has remarked it was the first time he got more than he wanted from the government."

This situation violates the spirit of ERISA, and I strongly believe that it also violates the letter of that law. Section 403(c)(1) of ERISA provides that, except in the event of a lawful termination, quote, "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries" and paying reasonable expenses. Section 401(a)(2) of the Internal Revenue Code provides for a similar restriction.

When assets are withdrawn from a pension plan and the plan still continues, as in the case of spin-off terminations, there is a clear violation of ERISA in that assets have been removed from a plan that in reality has not been terminated.

But don't listen to me, members of this committee. Listen to the Pension Benefit Guaranty Corp. and the Internal Revenue Service, the agencies entrusted with administering ERISA.

In a letter dated July 25, 1983, the executive director of the PBGC wrote to the assistant secretary of the Treasury urging him to conclude, as the PBGC had concluded, that spin-off terminations and termination reestablishments violate ERISA.

I ask unanimous consent that that letter be included in the record, Mr. Chairman.

Mr. CLAY. Without objection, it will.

Senator METZENBAUM. Thank you.

[The information follows:]

PENSION BENEFIT GUARANTY CORP.,
Washington, DC, July 25, 1983.

Re: Creation of "Plan" for Retired Lives Followed by Proposed Termination.

Mr. JOHN E. CHAPOTON,
Assistant Secretary for Tax Policy,
Department of Treasury, Washington, DC.

DEAR MR. CHAPOTON: At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts—one for active lives and one for inactive lives—coupled with the intent to terminate the inactive lives portion under circumstances discussed herein. The issue arises in cases: (1) where the plan has excess assets and the employer proposes to recoup all excess assets through termination of the inactive lives portion and (2) where PBGC guarantees are sought with respect to the termination of the inactive lives portion. I understand that you have this matter under consideration, and I trust that this letter will assist you in your determination and lead you to the conclusion that the PBGC position is the correct one.

The IRS position fails to recognize the realities of these situations which are designed to avoid specific requirements in the law and in the case of insufficient plans to dump liabilities on the PBGC. Over the years IRS has urged its step transaction theory on the courts, and has been largely successful in developing a body of case law which holds that steps taken by taxpayers will be disregarded when failure to cut through formalism will result in avoidance of tax liability not intended by the law. We submit that IRS should apply to the logic of the step transaction doctrine not only where there is tax avoidance but where the employer attempts to obtain excess assets or PBGC guarantees by structuring a transaction as a plan termination when in reality the plan is continuing.

Consider the reality of the purported creation of a separate plan for retired lives. By "spinning off" active lives, all that the employer has done is execute another plan document with the same provisions as the existing plan document but made applicable only to active lives. Presumably, the employer also made a formal transfer of assets and liabilities attributable to active lives. At this point, any resemblance to the existence of a separate plan for retired lives ceases. What exists are two plan documents and funds purportedly applicable to separate groups. But the retired lives "division" has none of the indicia of a separate plan. It is to terminate immediately. It is a creature fleetingly created, intended to smooth the path to a termination which, without this creature, would not be recognized by PBGC since under Title IV of ERISA a "partial" termination is not an insurable event. Contributions will never be made to the so-called "retired lives plan." It will never cover any active participants. This so-called separate plan is completely lacking in permanence.[1] The bottom line is that the arrangement amounts to no more than the continuance of payment of pension benefits to retirees and provision for benefits for other non-active lives, with the funding of all of these benefits through the purchase of annuities in an ongoing plan. This is the reality of the situation when one cuts through the trappings. In a sufficient plan with excess assets, annuities are purchased to the extent of the full accured benefits of the non-active lives. In the case of an insufficient plan, the benefits payable under the plan prior to the "carve-out" arrangement would be reduced to the level of PBGC guaranteed benefits if PBGC were to accept the termination of the "carved-out" plan.

Where there is a sale of a business and the buyer assumes only the active lives portion, PBGC's liabilities could be increased even further if the buyer is weak financially, plan liabilities increase without compensating funding and there is an eventual termination of the active lives part. If the buyer is strong financially, the carve-out arrangement, if permitted, would relieve the buyer of the funding of the non-active lives portion at the expense of the PBGC and its premium payers. We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and in many others is apparent. We would hope that from a policy viewpoint, you would be able to reach the same conclusion, and help prevent the abuse. Out General Counsel is of the strong opinion that our case is substantially weakened if IRS continues to maintain that the carve-out arrangement results in there being two separate plans.

Finally, at our meeting there was a discussion of the "Lubick letter," involving a case in which the Treasury Department and PBGC agreed that certain action did not give rise to a separate plan. As indicated in my letter of June 30, 1983, to Allen Winborne (copy enclosed) we feel that the reasoning in the "Lubick letter" applies equally in the cases discussed above.

I would appreciate very much hearing further from you this week if at all possible. We are actively engaged in litigation in an insufficient plan case, and a court deadline is imminent.

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[1] Indeed, we suspect that practitioners attempt to avoid the permanence issue by spinning off active lives to the "new" plan. If the steps were reversed, i.e., a spin-off of nonactive lives followed by proposed termination, the potential failure to satisfy the permanency requirements of the Treasury Regulations would be in full view.

Thank you again for your consideration.

Sincerely yours,

EDWIN M. JONES, *Executive Director.*

Senator METZENBAUM. Top IRS and Treasury officials met and discussed the PBGC conclusion that ERISA barred these terminations. On December 7, 1983, assistant IRS commissioner Allen Winborne wrote to the PBGC that it agreed and that the IRS would immediately move to stop such actions.

I ask unanimous consent that that letter be included in the record at this time.

Mr. CLAY. Without objection, it will be.

[The information follows:]

WASHINGTON, DC, *December 7, 1983.*

Mr. EDWIN M. JONES,
Executive Director,
Pension Benefit Guaranty Corporation, Washington, DC.

DEAR ED: Increasing attention has been focused in recent months on the issue of defined benefit plans terminating with surplus assets, where the surplus reverts to the employer. Under the Code, an employer is allowed to receive surplus assets from a terminated plan upon the satisfaction of all liabilities provided the excess is due to actuarial error. However, in some situations there are serious questions regarding the techniques being used to extract assets from plans. Two of the questionable techniques may be called the termination/reestablishment technique and the spinoff/termination technique.

Under the termination/reestablishment technique, an employer terminates an overfunded plan and recovers all excess assets. The employer then establishes a new defined benefit plan (perhaps identical to the terminated plan) for the affected participants.

The spinoff/termination technique may be exemplified by the following example. An employer splits its overfunded plan into two plans, one covering active employees and the other covering retirees. The employer then terminates the plan for retired employees and recovers the excess assets.

The principal affect of both techniques is that the employer is able to obtain plan assets that would not otherwise have been available while continuing a qualified defined benefit plan.

The techniques described present the possibility for serious abuses. The Service has been concerned about these abuses and has been studying the situation and the issues involved. In a recent meeting of the IRS-Treasury Policy Committee attended by the Commissioner, the Assistant and Deputy Assistant Secretaries for Tax Policy of Treasury, the Associate Chief Counsel (Technical) for the IRS and me, a decision was reached on the Internal Revenue Service policy in this area and the courses of action that are to be taken in an attempt to prevent the abusive recovery of excess assets.

The first approach involves application of the substance-over-form doctrine. Under this approach it is recognized that although each step in the process of recovering excess assets is permissible when considered independently, the substance of the transaction is that assets have been removed from an ongoing plan in violation of the Code. Thus, the substance of the transaction will be the primary determinant of the permissibility of the series of steps, not the validity of the formally independent steps. This approach may, in appropriate circumstances, also be applied to situations involving underfunded plans and the spinoff/termination technique in which the accrued benefits of participants are reduced.

The second approach to be used is called the actuarial error theory. This approach would apply only to the spinoff/termination technique. Under this approach, it is maintained that the surplus assets did not arise from actuarial error but from the spinoff of the plan. Thus, the employer would be precluded from obtaining the surplus assets.

Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately.

Sincerely,

S. ALLEN WINBORNE,
Assistant Commissioner.

Senator **Metzenbaum**. But the Department of Labor decided differently. They wanted to make sure that employers could get their hands on pension assets. So, the department appealed to the Cabinet Counsel. And what did the Cabinet Counsel conclude? A Cabinet Counsel memorandum dated March 13, 1984, states:

> Any type of plan termination may reduce the expected future pension benefits of active employees, even though past service benefits are fully protected.
>
> Any type of plan termination may have the effect of deferring or avoiding the taxes on the accumulated surplus in a qualified plan.

They then went on to say that, because there is no empirical evidence determining the nature and magnitude of this potential problem, "the affected agencies decided against addressing these issues as part of the resolution of the issues specific to the reversion of surplus assets."

Mr. Chairman, this administration has turned our pension system into a revolving bank account for corporations, permitting them to withdraw moneys at will, permitting them to deduct from their taxes when their taxes are at the highest point, and permitting them to withdraw the money when they have got tax shelters or tax losses and, therefore, paying no taxes on the withdrawals.

The profits they are earning and the investment risks taken by plan trustees are no longer, as required by law, for the exclusive benefit of pension participants. Listen to what Bob Monks, former administrator of the Office of Pension and Welfare Programs at the Department of Labor, has to say in a letter addressed to me. It was his job to administer this program. Said he:

> I have thought particularly about concerns you have voiced relating to the termination of pension plans and the reversion of surpluses to sponsor corporations. After a great deal of thought, I have come to the conclusion that there is a serious question of violation of existing law in the termination reversion process.

Mr. Chairman, before this administration assumed office, a principal purpose of our pension laws was to ensure that employers lived up to their pension promises. But not anymore.

This administration has pursued a course that encourages employers to terminate healthy pension plans.

Here is an ad run by the Institute for International Research, a 2-day conference for senior management held here in 1984 at the Vista Hotel. It says: "Should you, can you, how to access surplus cash from overfunded pensions, the commercial, financial, legal, tax, and personnel impact."

Mr. Chairman, I do not believe it appropriate, I consider it wrong for Mr. David Walker, acting director of the PBGC, for Mr. Harry Conoway from Treasury, for Mr. Francis Lilly, solicitor of the Department of Labor, to add stature and dignity and marketability for this kind of a seminar telling people how to take the pension funds and run with them. And that's what this administration is doing, because those three gentlemen saw fit to participate in the seminar. I consider that inappropriate. I don't believe that is within the scope of their responsibilities as public officials.

I believe the Department of Labor has been remiss in its responsibilities. They have let down in a disgraceful manner the working people for whom they are supposed to speak. We should be able to look toward the Department of Labor for leadership in this area. If the Department will not act to protect the rights of working people, then I believe that it is incumbent upon us to do so.

I am looking forward to working with and I have already discussed this matter with the Secretary of Labor. I believe that there should be a moratorium promptly with respect to any more terminations of these funds so that Congress may determine and evaluate what kind of legislative solution we think is appropriate.

I believe that the administration through Mr. Brock and others in the administration ought to come forward with some positive steps as to how we should deal with this problem while Congress legislates.

I believe, Mr. Chairman, very strongly that it is an imperative that we in the Congress address ourselves legislatively to this issue.

Mr. Chairman, I apologize if my remarks were longer than anticipated, but frankly, I feel very strongly about this issue. I do hope that your committees will see fit to act.

[The prepared statement of Senator Metzenbaum follows:]

PREPARED STATEMENT OF SENATOR HOWARD M. METZENBAUM

Chairman Clay and Chairman Roybal, I want to begin by commending you for addressing the issue of termination of overfunded pension plans. Your work in this area is a real service to millions of people in this country.

More than ten years ago Congress enacted the Employee Retirement Income Security Act (ERISA) for purposes of protecting workers' pension rights. ERISA was meant to ensure adequate funding for pension plans, to provide for vested pension benefits, and to hold pension plan administrators to the highest fiduciary standards.

There is no doubt that ERISA has had a positive effect. Important improvements have, in fact, been made in our pension system.

But today there are serious new problems—new horror stories as one major company after another shuts down pension plans. Why is this happening? Are the plans financially unhealthy? Are the companies experiencing economic difficulties?

We are talking about some of this nation's most healthy pension plans—plans that are sponsored by solid, profitable companies.

United Airlines, which earlier in this week announced its intention to terminate its pension plan, will undertake the largest reversion in history—$962 million will be removed from its plan.

The company claims it is terminating its plan in order to purchase additional aircraft. The fact is most of its fleet is grounded. It also says it wants to prevent a hostile takeover, but there are no indications of such a move.

The only thing not hypothetical about United's action is that it will rip-off its employees to the tune of $962 million leaving retirees out in the cold. It is a contemptible action to bring pressure to bear on a labor dispute. It violates every concept of what our pension laws were intended to protect.

Some other examples of terminations:

The controlling interest of A&P was acquired by a German company for an estimated $70 million. They terminated the plan and recouped $273 million.

Raymond International recouped $30 million to finance a leveraged buyout. According to its former senior vice president and board of directors member, it left more than half of its retirees living below the poverty line.

American Express, the first U.S. company to offer a pension plan, is now terminating in order to recoup $90 million.

Texaco, which paid $10.2 billion last year to acquire Getty Oil, will reduce its debt by removing $250 million from the Getty pension plan.

Mobil Oil, which found $5.7 billion last year to buy Superior Oil, will terminate two Superior plans and pocket $29 million.

And the list goes on. Occidental Petroleum, Dr. Pepper, Champion Paper, Humana, Mattel, Reynolds Metals, U.S. Sugar—all of these have terminated pension plans.

And most likely, additional terminations are in the offing. A recent survey of 200 defined benefit plans by Charles Spencer and associates found that 83% were "overfunded," making them prime candidates for termination.

For the major corporations of this country, pension plan terminations are a financial bonanza. But for the working men and women of this country, the impact is truly devastating.

According to the Department of Labor's own study, the cost of termination to workers runs as high as 45 cents on every promised pension dollar. Terminations deprive retirees of any hope of receiving future cost of living increases. Employers are routinely breaking promises to distribute pension surpluses to their employees.

Pension plan terminations hurt segments of our population—the elderly, and the older worker—that are least able to protect themselves. These are hard working people—people who have played by the rules. These are Americans who have looked forward to retirement with what they rightfully thought was a federally protected level of retirement income, only to discover that they are the victims of hollow promises.

I believe that the time has come for action to protect the integrity of our nation's pension system. During the last Congress, I introduced legislation to impose a nine month moratorium or terminations. Chairman Roybal introduced a similar bill in the House. In addition, I offered an amendment in the Senate Labor Committee that would have dedicated a portion of excess assets to pension participants.

The administration opposed efforts but promised to complete a study on the issue of terminations and report back to Congress. I have seen no action, and, as far as I know, there is no study underway. In fact the only thing this administration has done to date is to issue guidelines that permit so-called spin-off terminations and termination reestablishments. In a spin-off termination an existing pension plan is divided into two plans—one for active workers and one for retirees. The employer then terminates the one for retirees and recovers the excess assets. In a termination reestablishment, an employer terminates an overfunded plan, removes the excess assets, and then commences a new plan similar or identical to the one just terminated.

How effective are these guidelines in protecting participants? Not very. According to a story in Pension and Investment Age (April 29, 1995), "a pension attorney who led an ad hoc group of lawyers seeking to allow the new technique (of spin-off terminations) has remarked it was the first time he got more than he wanted from the government."

This situation violates the spirit of ERISA, and I strongly believe that it also violates the letter of that law.

Section 403(c)(1) of ERISA provides that except in the event of a lawful termination "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." Section 401(a)(2) of the Internal Revenue Code provides for a similar restriction.

When assets are withdrawn from a pension plan and the plan still continues, as in the case of spin-off terminations, there is a clear violation of ERISA in that assets have been removed from a plan that in reality has not been terminated. But don't listen to me—listen to The Pension Benefit Guarantee Corporation and the Internal Revenue Service, the agencies entrusted with administering ERISA.

In a letter dated July 25, 1983 the executive director of the PBGC wrote to the assistant Secretary of Treasury for tax policy urging him to agree with the PBGC that spin-off terminations violate ERISA:

"At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts . . . coupled with the intent to terminate the inactive lives portion . . .

". . . I trust that this letter will assist you in your determination and lead you to the conclusion that the PBGC position is the correct one.

"The IRS position fails to recognize the realities of these situations which are designed to avoid specific requirements in the law . . . We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and in many others is apparent. We would hope that from a policy viewpoint, you would be able to reach the same conclusion, and help prevent the abuse."

The IRS was convinced. In a letter dated December 7, 1983, Assistant IRS Commissioner Allen Winborne wrote that the spin-off termination and termination reestablishment "present the possibilities for serious abuses." The service has been concerned about these abuses and has been studying the situation and the issues involved. In a recent meeting of the IRS-Treasury policy committee attended by the commissioner, the assistant and deputy assistant secretaries for tax policy of treasury, the associate chief counsel (technical) for the IRS and me, a decision was reached on the Internal Revenue Service policy in this area and the courses of action that are to be taken in an attempt to prevent the abusive recovery of excess assets.

First, ". . . the substance of the transaction is that assets have been removed from an ongoing plan in violation of the code.

And "the surplus assets did not arise from actuarial error, but from the spinoff of the plan. Thus, the employer would be precluded from obtaining the surplus assets.

"Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately."

But the Department of Labor decided differently. They wanted to make sure that employers could get their hands on pension assets. So the department appealed to the cabinet council. And what did the cabinet council conclude?

A Cabinet Council memorandum dated March 13, 1984 states the following:

"1. Any type of plan termination may reduce the expected future pension benefits of active employees, even though past service benefits are fully protected. . . . The empirical evidence does not now provide an adequate basis for determining the nature and magnitude of this potential problem.

"2. Any type of plan termination may have the effect of deferring or avoiding the taxes on the accumulated surplus in a qualified plan. The empiricial evidence does not now provide a basis for determining the nature and magnitude of this potential problem. . .For the reasons described above, the affected agencies decided against addressing these issues as part of the resolution of the issues specific to the reversion of surplus assets."

Mr. Chairman, this administration has turned our pension system into a revolving bank account for corporations—permitting them to withdraw monies at will. The profits they are earning and the investment risks taken by plan trusteees are no longer, as required by law, for the exclusive benefit of pension participants. Listen to what Bob Monks, former administrator of The Office of Pension and Welfare Programs at the Department of Labor, has to say in a letter addressed to me:

"I have thought particularly about concerns you have voiced relating to the termination of pension plans and the reversion of surpluses to sponsor corporations. After a great deal of thought—it is set forth on pages 35 and 36 of the enclosure—I have come to the conclusion that there is a serious question of violation of existing law in the termination reversion process."

Mr. Chairman, before this administration assumed office, a principal purpose of our pension law was to ensure that employers lived up to their pension promises. But not any more.

This administration has pursued a course that encourages employers to terminate healthy pension plans. In fact, administration officials are holding seminars across the country for the purpose of advising corporate executives on how to terminate.

I believe that the Department of Labor has been remiss in its responsibilities. They have let down in a disgraceful manner the working people for when they are supposed to speak.

We should be able to look towards, the Department of Labor for leadership in this area, and, if the Department will not act to protect the rights of working people, then I believe that it is incumbent upon us to do so.

Senator **Metzenbaum**. I might ask you, Mr. Chairman, if I might have leave to include in the record a copy of the letter from Mr. Monks.

Mr. **Clay**. Without objection, it will be.

[The information follows:]

Ram & Co.,
Washington, DC., April 25, 1985.

Hon. Howard M. Metzenbaum,
U.S. Senate,
Washington, DC.

Dear Howard: I continue to spend a great deal of time thinking about ERISA needs and enclose for your consideration the rather detailed valedictory that I prepared following extensive hearings in January.

I have thought particularly about concerns you have voiced relating to the termination of pension plans and the reversion of surpluses to sponsor corporations. After a great deal of thought—it is set forth on pages 35 and 36 of the enclosure, I have come to the conclusion that there is a serious question of violation of existing law in the termination reversion process. "In other words, if the inflation-indexed government bond produces exactly the needed results, what excuse can there be to incur any risk to achieve results which are surplus, and therefore by definition not for the exclusive benefit of the plan participants? For whom is the manager managing? The statute and its exclusive benefit rule are unmistakable in stipulating that all plan assets must be held solely for the benefit of the participants. And yet the existence of pension plans is wholly voluntary. Any excesses above vested benefits can be returned to the corporate sponsor in the event that he in his uncontrolled discretion decides to terminate the plan. Many companies have, in fact, terminated their plans in recent months."

Obviously if the law is being violated by existing practices, substantial leverage exist to work out more equitable solutions than those occurring in the past two years.

Respectfully yours,

ROBERT A.G. MONKS, *President.*

Enclosure.

OFFICE OF PENSION AND WELFARE BENEFIT PROGRAMS HEARINGS SUMMARY

Enclosed for your review is a summary of the hearings conducted in New York and San Francisco by the Office of Pension & Welfare Benefit Programs (OPWBP) in January 1985. This summary was prepared by Robert Monks, the former Administrator and Janet Brown, Special Assistant to the Administrator. A copy of the transcript of the hearings and materials submitted for the record are available for review in OPWBP. The Department welcomes your comments on the summary. Written comments should be directed to the Office of the Administrator, OPWBP, 200 Constitution Avenue, N.W., Room S-4516, Washington, D.C., 20210. The record of the hearings is in the process of final verification by the participants. When this process is complete a final summary report will be complied with new page references and amended quotes as necessary.

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CONCLUSIONS

C. Risk-taking

The testimony of several senior ERISA experts was particularly illuminating. Pete Harrison has been the in-house manager for one of the more conspicuously successful private plans (Carnegie/U.S. Steel). In his remarks, Harrison noted: "My conclusion from 30 years in this field is very simple. You should drive as fast as you can, recognizing that snowballs will come through the windshield in July some years, that 13% government bonds will not totally protect an enterprise or its employees for their lifetime, that it is vital each month for the pension checks to clear the bank without your having to sell IBM at 57." [31] The current Chairman of Endowment Management & Research Corporation also stressed the certainty of violent change, even though there is uncertainty from which quarter it may come. He comented on the practice of taking advantage of high interest rates to "dedicate" portfolios: "An essential part of successful investment strategies is flexibility—the ability to shift assets as prices, values, returns, conditions, and prospects change. Bond immunization denies that need."[32]

The best strategy, therefore, for institutional investors generally is to have quick access to a different investment posture. But is this necessarily a correct posture for pension funds? Pension funds' needs can be simply stated: to provide at minimum risk a series of payments at known future intervals that will have purchasing power bearing an pre-determined relationship to salary levels then obtaining. It is clear that such a security exists in theory: an inflation-indexed U.S. Government bonds.[33]

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[31] Hearings, January 9, 1985, written statement by Graham O. Harrison, p. 6.

[32] Hearings, January 9, 1985, written statement by Peter Vermilye, p. 3.

[33] Introducing inflation considerations into investment policy for defined benefit plans is to ask the ultimate and most difficult question. With defined contribution plans, performance risk is all on the individual participants. With conventional defined benefit plans, the sponsor only obligates himself to make fixed payments. Over time, pensions have taken inflation into account by tying payment levels to final salaries. Almost no sponsors, however, have been willing to index payments to those already retired to inflation. An inflation-indexed security would permit this irrespective of the timing of an individual's retirement. The concept of an inflation-indexed security is posed as a "theoretical possibility" against which to evaluate the risks and returns derived through conventional management.

Witnesses' objections to indexed securities, whether indexed to inflation or to a market proxy (S&P or Wilshire 5000), focused on several factors. Some, such as Harrison and Vermilye, believe that ". . . over time a minority of managers turn in consistently superior results." [34] The concept of the consistency superior manager is the stuff that maintains this hugely profitable industry.

If the definition of objectives has been accurately stated above, it is difficult to justify taking any risk beyond that necessary to achieve the stipulated goals. In other words, if the inflation-indexed government bond produces exactly the needed results, what excuse can there be to incur any risk to achieve results which are surpluses and therefore by definition not for the exclusive benefit of the plan participants? For whom is the manager managing? The statute and its exclusive benefit rule are unmistakable in stipulating that all plan assets must be held solely for the benefit of the participants. And yet the existence of pension plans is wholly voluntary. Any excesses above vested benefits can be returned to the corporate sponsor in the event that he in his uncontrolled discretion decides to terminate the plan. Many companies have, in fact, terminated their plans in recent months.

There is an obvious conflict. As Professor Ratner put it: " . . . [T]he people who are managing the funds do not have the same interests as the beneficiaries of the funds.[35] The "wise men" want to invest pension funds prudently, as prudence has been defined in their other fiduciary incarnations. However, assuming the ERISA pension requirements can be met today by providing the legally required cash flows from government bonds,[36] does not a sponsor and possibly his delegated managers run the risk of surcharge for losses incurred by risks in excess of those necessary to achieve the plan's objectives? If the only use of excess funding is for return to the sponsor on termination, or as a reduction of immediate funding obligations by the sponsor,[37] is there not an actionable conflict of interest in taking risks beyond those involved with a "dedicated bond portfolio?" The inflation-indexed U.S. bond doesn't exist, but the problem of conflict of interest bears substantial further attention. Note that the whole question only arises because there are no explicit policies—no obligations with respect to percentage of pre-retirement pay or indexation. In this free world, everyone has the impression that their profit maximizing behaviour is in everybody else's interest. It may just constitute an actionable conflict of interest.

Many of those testifying objected to indexing on the grounds that if everybody indexed, there would be no freely created market values any longer. Thus, the need for statistics becomes the operative consideration.[38] A further concern relates to separating the fate of pension recipients from the rest of the economy. As Professor Scholes put it: "A government issuing a real rate bond with a real rate guarantee could end up subsidizing pension funds." [39] There seems to be no objection to inflation-indexed bonds from the point of view of achieving pension policy objectives.[40]

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[34] Peter Vermilye, op. cit., p. 5. Dean LeBaron alluded to the possibility that managers will have to develop new skills, to become active, to learn from the "corporate finance" departments in order to achieve acceptable results: "Finding the unique investment is not necessarily the only way in which one can achieve a target investment return. So institutions may develop some of these corporate skills . . . free market solutions are likely to arise quicker and probably better targeted than imposed solutions. And so the unbundling or the separation of the franchise, the equity or financial franchise from the control franchise . . . And there . . . you have an ideal setup for a market . . . high demand." Hearings, transcript, Jan. 10, 1985, Dean LeBaron, pps. 69-70.

[35] Hearings, transcript, Jan. 14, 1985, Prof. David Ratner, p. 76.

[36] As mentioned earlier, the preponderance of "defined benefit plans" today does not require inflation adjustments. These liabilities can be offset with existing government bonds (government bonds are stipulated because they have the lowest risk).

[37] Hearings, transcript, Jan. 14, 1985, Vernon S. Hodge, p. 254. "If the plan does well, the sponsor reduced his costs. If the plan does poorly, the sponsor increased his costs."

[38] Hearings, transcript, Jan. 9, 1985, Prof. Stephen A. Ross, p. 67, et seq. Hearings, transcript, Jan. 14, 1985, Peter Dietz, p. 122.

[39] Prof. Myron Scholes, op. cit., p. 154. Hearings, transcript, Jan. 9, 1985, Sophie Korczyk, p. 169. "All taxpayers would wind up paying higher taxes to protect pension participants in the event of unexpected inflation."

Hearings, transcript, Jan. 9, 1985, Prof. Marshall Blume, p. 51. "The government is essentially then guaranteeing the real productivity increases in the country."

[40] Prof. Stephen A. Ross, op. cit., p. 5. Ross offers the following refinements: "While such [inflation-indexed] bonds offer protection against inflation, they exacerbate the real risks faced by the fund and simply don't address the other matters that should be of concern to pension funds. The risks faced by such funds extend beyond inflation to general questions of the business cycle and of real productivity. It is my view that pension fund investments should be structured so as to protect the fund, the beneficiaries, and the sponsors against undue exposure to these risks and ignoring them by investing in indexed bonds does not accomplish this. An employee with a

Continued

The unique characteristics of pension plans do not appear to have been taken into account. The assumption that risk/reward calculations suitable for other institutional investors are also suitable for pension plans has not been critically examined. The fact that investment performance of pension plans is less than optimal is at least in part attributable to failure to develop strategies (and securities) appropriate for their particular need.

Mr. CLAY. Senator, I would like to start by asking you if you are still the only one in the Senate interested in this problem.

Senator METZENBAUM. I think that there must be a few others. Maybe they haven't been as loud as I.

Less facetiously, there are others in the Senate who are concerned. There are others, I believe, who would be prepared to come forward and be supportive. But, frankly, there hasn't been enough concern evidenced in the Senate and maybe not enough in the House either. I think the problem is that the horse is getting out of the barn day by day, and it's pretty hard to bring it back and put it in. If we don't act promptly, I am afraid there may not be much left to deal with by the time we get around to it.

Mr. CLAY. There is quite a controversy surrounding who actually owns the excess funds in a plan. In your opinion, to whom do these funds belong?

Senator METZENBAUM. I believe that the funds indeed belong to the beneficiaries. I believe that is what the law indicates, to be used for the exclusive benefit of the employees and the retirees. I believe they are their funds.

I tried at one point to work out some sort of an interim solution with some of the members of the other party dealing with this issue last year, in which I tried to get them to agree that at least there would be enough kept in the funds to provide for inflationary adjustments over a period of years. They were not receptive to that. As a consequence, I could not move the legislation.

But I believe that the funds belong to the retirees and the employees themselves, not to the employer.

Mr. CLAY. Thank you.

Mr. Roybal.

Mr. ROYBAL. Senator, I would like to compliment you, first of all, for an excellent statement and for telling it like it is. There is no doubt that your testimony is a clear outline of what has happened particularly with regard to the Department of Labor, to IRS, and to the Pension Benefit Guaranty Corp.

When you and I first started on this matter about 2 years ago, a little before that time, you and I were the only ones that seemed to be interested. You say that there may be a few in the Senate. I doubt that there are very many in the Senate that are interested. There are not too many in the House that are interested.

The truth of the matter is that this is a problem. Something has to be done. But it is starting to become a partisan issue. There are those who defend it because the administration is on one side. Then there are those of us who want to straighten it out, and we are sometimes accused that we do that because we are not regis-

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defined contribution plan, for example, is not well served by an investment policy that in no way hedges against the risk of increased unemployment because of downturns in the business cycle."

tered Republicans. That is unfortunate. I think we ought to look at this thing and make a judgment on its merit.

What power does the Pension Benefit Guaranty Corp. have? Can they put a stop to that, or can the Internal Revenue Service do it?

Senator **METZENBAUM**. I myself believe that the Pension Benefit Guaranty Corp. does have authority, legal authority to put a stop to it. They are not inclined to use it. They say their only responsibility is to concern themselves about whether or not the premiums will be paid and the security of their fund. I don't agree with their interpretation of the law. I think that they are turning their back on the issue.

Mr. **ROYBAL**. Do you believe then that they do have oversight capability and that they could do something?

Senator **METZENBAUM**. I do indeed believe that.

Mr. **ROYBAL**. Thank you, Senator.

Mr. **CLAY**. Mr. Rinaldo.

Mr. **RINALDO**. I have no questions, Mr. Chairman.

Senator **METZENBAUM**. Mr. Rinaldo, might I just take this moment to commend you upon your very excellent opening statement? I know Mr. Roybal just commented on the fact that it might be a partisan issue. I think your statement indicates quite clearly that you recognize that it is not a partisan issue. I don't want to make it a partisan issue. The fact that I criticize the administration is only because the administration hasn't done its job. But I certainly want to doff my hat to you, sir.

Mr. **RINALDO**. Thank you very much. I appreciate your kind comments.

Mr. **CLAY**. Mr. Pepper.

Mr. **PEPPER**. Thank you, Mr. Chairman.

Senator Metzenbaum, it is characteristic of your great career that you would be here today speaking out for these employees who have so few to speak for them and who are being deprived by their employer, which they regarded as their protector of the hope of a decent life in their time of retirement.

It is rather interesting in a press release that I have in my hand, issued by United Airlines, has these words issued by the company: "recapturing these assets is a vital investment in our company's future and our efforts to build United Airlines"—Sir John L. Cowing, executive vice president of finance—"This action will strengthen United Airlines financially and will provide more accurate reflection of our financial position."

I had thought, and I believe it is still true, that business in this country—I mean by that those in responsible position in the management of business—are seeking to broaden their service to their employees and help their service people enjoy a better life. This looks like regrettable reactionary trends. They are thinking it will be better for the company to take back these assets than to maintain a system for the benefit of the company and the employees.

I was aggrieved to hear you say that apparently the administration is not turning its hands and making any efforts to try to determine what is right. These people out there that retire primarily rely upon these pension systems. To a large degree many of them do.

Even with Social Security, the elderly people, that is, those retired and of retirement age generally in this country, a sixth of them still have incomes below the poverty level. When you deprive them of their pensions or diminish the value of their pension, you are lowering the standard of their lives.

So, I am glad to hear you raise your great voice today in condemnation of that attitude. Let's try to help one another more rather than to take away from those that we have been seeking to help.

Senator **Metzenbaum**. Thank you, Congressman Pepper.

Mr. **Clay**. Mr. Saxton?

Mr. **Saxton**. Senator Metzenbaum, let me congratulate you also on your fine statement and say that I appreciate very much the information that you have provided for us today. As a member of a State legislature, I served as a member of the pension study commission, as a member of the committee that addressed pension plans legislatively. So, I have a great deal of appreciation for the necessity of keeping pension plans strong. Of course, those were basically State-run and operated pension plans; but I do have that background and understanding.

We have a chart of various pension plans that have been terminated. I just wanted to ask you if you would respond to perhaps one example of a corporation which showed assets in its pension plan of about $156 million and a liability for benefits over the years to about 8,325 participants in the plan at a cost of benefits of about $99 million. It showed that $56 million reverted to the company when the pension plan was terminated.

Can you explain what effect that would have on the participants in the pension plan?

Senator **Metzenbaum**. Yes. It would preclude with certainty any chance of those participants, those who had given of their own lives to make the company and of their own salaries, because in some ways those pension funds were certainly part of the cost of labor, it would preclude any chance of their getting any inflation adjustments in the future.

And it is fair to point out that probably the overwhelming majority of pension plan administrators, which in the main are part of the employer group, because they are mainly administered by employers, have provided inflation adjustments over the years when the fund was able to do so. This provides with certainty that in that company there will never again be an inflation adjustment. It's finis. It's terminated.

Mr. **Saxton**. And that means that there are 8,325 individuals who work for that company who can look forward to no cost-of-living adjustments when they retire?

Senator **Metzenbaum**. That's right. And here we are in the U.S. Congress battling on the whole question. One of the major issues is a cost-of-living adjustment with respect to Social Security. As a matter of fact, we are talking about a cost-of-living adjustment, only we call it an inflation adjustment, with respect to the Defense Department, that kind of an issue.

But for these employees—and the thing that I think people have to appreciate is that these aren't a group of outside employees. These are the people who made the company, maybe gave 30 years of their life, 25 or 40 years, and they toiled at the machines, whatever it was that they were doing, and to just turn your back on them is wrong.

In my testimony I pointed out that a senior vice president and former board member of one of the companies came before a hearing we held in the Senate on this issue and said how unfair and how embarrassed he was about the fact. When he took it up with management, the door was slammed in his face; and they were not even willing to talk about it.

Mr. SAXTON. Senator, I have just one final question. This one company had over 8,000 employees that were affected. Do you have an estimate of what the number of employees nationwide might be that would be affected?

Senator METZENBAUM. Almost a million is our understanding as of this point. Their numbers are adding daily.

Mr. SAXTON. Thank you very much. Thank you for taking the lead in this subject, Senator.

Senator METZENBAUM. Thank you.

Mr. CLAY. Mr. Biaggi?

Mr. BIAGGI. Thank you, Mr. Chairman.

I think, Senator, clearly you are to be commended for your statement and your response to the questions. Our mutual concern for the seeming lack of interest, I don't think, has sufficient basis. Clearly, you make the case, and I think the issue is such an imperative one, if for no other reason than from a moral perspective, that I am confident that the Congress will respond.

The joining of these two committees today and the interest manifested here clearly indicate our concern. I am confident that there will be some resolution. Clearly, what is happening is that the employees are at risk.

It boggles the mind to think that corporations would attempt to do this. It is a rape of the pension systems, clearly.

I can understand in the illustration that you just gave why the corporate heads would turn and close the doors on that vice president. They see this plum at the end of the rainbow. They see it as something that can be plucked and be used for corporate advantage and employee peril. But this is not uncommon. Since, as I say, we, the Congress, have addressed ourselves in the last 10 years to correcting the inequities in the pension systems, we find a number of backdoor approaches and denials of employee rights.

I just introduced legislation yesterday cosponsored by Senator Pepper and the ranking minority member of Aging, Mr. Rinaldo, that would clear up the condition. We are in a position to eliminate mandatory retirement and permit individuals to work until 70. Yet, their pension rights cannot accrue beyond 65. So, clearly, that is a very substantial diminution of their rights. And that is something that has occurred.

This whole area is one that Congress and the administration should respond to. I believe that we are all well intended, and we have an honest approach. But in the formulation of legislation—and you have had more experience in this area than I—we know there isn't any perfect vehicle. When we find the loopholes, we should correct them. This is a perfect illustration of one error, one at least omission that should be addressed and be addressed vigorously and quickly. I can't commend you sufficiently for your most comprehensive statement. You have made the case very clearly.

Senator **Metzenbaum**. Thank you, Mr. Biaggi. I look forward to working with you.

Mr. **Clay**. Mrs. Bentley?

Mrs. **Bentley**. Thank you, Mr. Chairman.

Senator Metzenbaum, I want to thank you for presenting this matter so clearly and concisely. I also want to thank you for your remarks that this is not a partisan issue.

Senator **Metzenbaum**. Thank you.

Mrs. **Bentley**. I believe we are all concerned about what is happening to pensions and pension rights of the citizens of this country. I know I am, and I know that my colleagues here are. I assure you that this matter will be given my full attention as well as, I am certain, those of my Republican colleagues here today and others.

Senator **Metzenbaum**. That is very reassuring, Mrs. Bentley, and thank you very much.

Mr. **Clay**. Mr. Owens?

Mr. **Owens**. I have no question, Mr. Chairman. I just want to commend the Senator for throwing light on the subject. We are very much aware and have been concerned about underfunded pension plans. I find your statements and the other information that we are receiving here today to be astonishing. Thank you.

Senator **Metzenbaum**. Thank you.

Mr. **Clay**. Mrs. Meyers?

Mrs. **Meyers**. Mr. Chairman, as a freshman, I would like to make sure that I understand fully the problem. As I understand it, the companies are able to do this by changing the plans?

Senator **Metzenbaum**. By terminating the plans, actually. What they do is, they terminate the plan and they put them in two different categories. One is those employees who continue to work. And the other is those employees who are retired. With respect to those who are retired, they then buy annuities for them. They are defined benefit plans. So, the annuity provides for that defined benefit. There is an excess of cash, and they take that cash out.

Do I make myself clear?

Mrs. **Meyers**. Yes, you do.

Does it change the benefits for those people who are already retired? Are they getting what they expected to get? Are they being denied something that was promised them, as I understand what you are saying?

Senator **Metzenbaum**. I don't think it would be fair to say that, Mrs. Meyers, and I don't want to say that. They were promised, let's say, $400 a month. So, on that basis they will get the $400 a month. But the realities are that pension plans have traditionally—and there have been some very major pension plans over this Nation's history, that, as inflation made the dollar worth less and as inflation made the pension fund grow in value, either from stocks or from much higher yield on bonds, the managers of the plan, most often operated, in fact, by employers—some are jointly operated but more of them are operated by the employers—the employers saw fit to recognize the inflationary impact and provide an inflationary adjustment. And they had the wherewithal to do it.

Now they will no longer have that wherewithal.

Mrs. **Meyers**. I see. In other words, those who are already retired are not being denied what they were promised. But in the past they have usually profited from the inflationary benefits of these funds. Under this plan, because they purchase annuities, they do not.

Senator **Metzenbaum**. That is correct.

Mrs. **Meyers**. Thank you very much.

Senator **Metzenbaum**. Thank you.

Mr. **Clay**. Mr. Atkins?

Mr. **Atkins**. Senator Metzenbaum, I know that you don't agree with United Airlines in their statement that they had terminated their plan because they were concerned about a hostile takeover. But I am wondering in other circumstances if you think there is a problem with companies with significantly overfunded pension plans becoming targets for hostile takeovers, situations like the A&P situation, where a controlling interest was bought for $70 million and then the company turned around and terminated the plan and recouped $273 million.

Senator **Metzenbaum**. I don't believe that pension plan funds should be an issue with respect to the matter of hostile takeovers. By coincidence, I just left a committee hearing that started at 9 o'clock having to do with the entire issue of hostile takeovers. I don't think that anyone can generalize as to the rightness or the wrongness of hostile takeovers, because in some instances management perhaps has been remiss in its responsibilities. I think you have to be concerned ultimately, at least this Senator is mostly concerned, about the rights of the shareholders. It is the shareholders that people seem to forget about with respect to the whole matter of takeovers.

I don't want to make a lecture on that subject, but I do strongly believe that the pension fund surpluses should not be used or permitted to be used for the purpose of either fending off or making possible a hostile takeover. I don't believe that was their original purpose. I don't think that particularly benefits the retired employees or the present employees.

Mr. **Clay**. Mr. Fawell?

Mr. **Fawell**. Senator, I want to add my voice. I appreciate your testimony very much.

I think maybe I should be categorized as the devil's advocate here, and maybe that's not a good way to classify me. But it seems to me there have been some strong statements made when we talk about milking the pension funds or the rape of the pension systems. Not all of these statements are attributable to you, but I think I have heard them this morning——

Senator **Metzenbaum**. Some are.

Mr. **Fawell** [continuing]. Or that we have what is a revolving bank account allowing them to withdraw at will.

It doesn't seem to me—I stand to be corrected here—that there is any at-will ability to withdraw. In fact, the converse seems to me to be there. That is that the only way in which an employer may obtain the benefit of excess funds over and above what are actuarially needed for the future is to use the only method apparently granted by ERISA, as I understand it, and that is termination, which may say to us that, hey, there is a lacking in the law.

Is that a fair comment?

Senator **Metzenbaum**. Well, I think that is true. You need the termination and the determination as to when and where that termination will occur rests in the uncontrolled discretion of the employer—which happens to be the language of Robert Monks, the former head of this particular agency within the Department of Labor. He says that any excess above vested benefits can be returned to the corporate sponsor in the event that he in his uncontrolled discretion decides to terminate the plan.

Now, it is correct that the corporate executive can't go in and pull out 50 million this week and then go back 3 months or 1 year later and pull out another 100 million. So, from that standpoint, if I understand the thrust of your question, Mr. Fawell, it is not just an at-will ability to withdraw at any time he wants.

Mr. **Fawell**. That is the point, Senator, that I was thinking about. The only source apparently is to utilize this one method of termination, which speaks to me that there is something lacking in the law. We talk about employees being at risk, and I do agree that employees do lose something when you have a termination and the ad hoc cost-of-living increases, for instance, which are not mandatory. I gather, however, that there are very few plans, if any, where they are mandatory.

But the employer, too, is at risk because, as I understand it, if you have a downturn in the market and a liability, it is the employer who has to make it up. What I am suggesting is that perhaps some of the wording is a bit too strong that employers—and pension law has grown a little topsy—go into these plans at considerable risk, also. At times, the law doesn't even basically give them the opportunity to borrow from the funds. Perhaps I am incorrect there. They have no ability, however, having fulfilled basically their responsibility, and maybe even wanting to leave a sizable cushion, they have no access to funds which at least to a degree can be termed to be partially theirs, too.

You are not saying, are you, that the employers do not have any right to any of these funds whatsoever, are you?

Senator **Metzenbaum**. No. I am not saying that. I am saying that this is an issue that I am certain is being resolved in the wrong way at this point. I therefore proposed last year, along with Mr. Roybal a 9-month moratorium so that Congress might sit down with the managers of these pension funds, sit down with the representatives of union groups, sit down with the employer groups and say: Look, what's the fair thing to do? But, unfortunately, the administration permits this to just go on.

What I believe is yes, the employers have some rights. And I don't want to be put in the position of saying they don't have any rights to these funds at all. I think that there is some argument that can be made on their behalf. At this moment, however, what is happening is that they are getting the whole ball of wax, and the employees are getting zero.

I think that, if there were a rational, reasonable approach to the matter, it could be resolved in a way that I think would be fair to everybody.

Mr. **Clay**. The time of the gentleman has expired.

Mr. Dymally?

Mr. **Dymally**. Thank you, Mr. Chairman.

Senator, this is a subject which is not well known to the public at large and certainly to many, many Members of Congress, including myself. I take it that you are saying that the employees have a vested right in the excess profits earned by the pension fund. Is that correct?

Senator **Metzenbaum**. Correct.

Mr. **Dymally**. What loophole, if any, is in the law that permits the employer to invest these funds without consulting with the vested interests?

Senator **Metzenbaum**. There is nothing in the law that requires these funds to be jointly operated between representatives of the working people and the employer. Let's face it, these funds originally were created over a period of time when employers out of their largesse decided that this was the right thing to do. We then moved into a period of time in our economy where unions negotiated for pension plans. Some of those where unions have been involved do provide for joint management of the funds. But many of them still are totally operated and directed by the employer itself.

So, there has been nothing in the law specifically providing that there had to be joint or some kind of cooperative arrangement between the employer and the employee representatives. The employers have just continued to act in this manner and have continued to liquidate the funds when they deemed it appropriate to do so, and the government has not stepped in.

I believe there is some illegality. I have indicated publicly that, if I were involved or in a group of people involved in this, I said it to United Airlines employees today, if they want to file a suit challenging that termination, I would be willing to join in that case, although I am not certain that I am a real party in interest and might get thrown out of court. But I feel so strongly about it that I feel that it is not a legal thing to do.

I think that, unfortunately, there is nobody to enforce the law at this moment.

Mr. **Dymally**. Your position is then the Department of Labor has the authority to stop this raid on the funds?

Senator **Metzenbaum**. I think the Department of Labor, the PBGC, and the Internal Revenue Service all have it. But the command post at the White House came down and said last year, stand back, we don't want to go in that direction. As a consequence, the IRS just absolutely reversed its position. Now we have the letter from Mr. Monks, former head of the Department of Labor agency involved with this particular issue, saying that he thinks it's illegal. So, I think there is a real question of illegality, and nobody is pressing to maintain that position.

Mr. **Clay**. The time of the gentleman has expired.

The Chair would like to request cooperation from the members. Because of the great interest in this subject and the large number of members who have shown up for the hearing, we are having a little time problem here. I would like to request that members limit themselves to asking one question. Of course, it's implicitly implied that you don't make any long speeches leading up to that question.

Mr. Lightfoot?

Mr. LIGHTFOOT. With that, Mr. Chairman, I would like to thank the Senator for his testimony. I have no questions.

Mr. CLAY. Thank you.

Mr. Hayes?

Mr. HAYES. Thank you, Mr. Chairman. Brevity is my middle name.

I do want to just make a statement and see if the Senator agrees. I certainly appreciate your raising, the good Senator from Ohio, the issue of pensions. I am a little bit bothered when I look at the list of companies that benefited already from this, this ripoff, as I call it. Some of them are in the oil industry. I understand that the President's proposed tax reform further insulates them against payment of taxes under the guise of having money to explore for oil.

Is there any legislative remedy being planned in your legislative end of our Government to offset or close loopholes which permit this kind of situation to develop?

Senator METZENBAUM. You are talking about the loophole with respect to pensions?

Mr. HAYES. That's right.

Senator METZENBAUM. The answer is, "yes." And I might say we have legislation that we are prepared to move forward with. Representative Roybal, I think, has 15 cosponsors on his legislation. I am certain that he would welcome additional cosponsorship. Representative Roybal and I are not really in disagreement as to the legislative thrust.

Mr. HAYES. Thank you, Mr. Chairman.

Mr. CLAY. Thank you for your cooperation.

Mr. Boehlert?

Mr. BOEHLERT. No questions, Mr. Chairman. I can listen and pay attention.

I just have a shared concern for employees' pension benefits and rights and a commitment to work on a bipartisan basis to come up with a sane termination reversion plan. I want to thank the Senator for his eloquent testimony.

Mr. CLAY. Thank you.

Mr. Schuette?

Mr. SCHUETTE. I have no questions at this point in time.

Thank you, Senator, for your testimony.

Senator METZENBAUM. Thank you.

Mr. CLAY. Senator, we really want to thank you for your testimony. You have been most gracious with your time. Thank you.

Senator METZENBAUM. Thank you. And I never thought that I would participate in a filibuster in the House.

Mr. CLAY. The next witnesses will consist of a panel: Arthur Wilson, Dudley Smith, Percy Penley, Karen Friedman, and Bert Seidman.

Without objection, all of your statements will be included in the record in their entirety. You may proceed as you desire.

Who is first? Mr. Wilson? We request that you summarize your statement in view of the time constraints that we have.

PANEL ONE: CONSISTING OF ARTHUR WILSON, PRESIDENT, LOCAL 898, THE OIL, CHEMICAL & ATOMIC WORKERS INTERNATIONAL UNION; DUDLEY B. SMITH, FORMER EMPLOYEE AT CELANESE CORP., BROOKINGS, OR; PERCY PENLEY, CELANESE CORP. RETIREE, LOUISVILLE, KY; KAREN FRIEDMAN, PENSION RIGHTS CENTER, WASHINGTON, DC; AND BERT SEIDMAN, DIRECTOR OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY, AFL-CIO

STATEMENT OF ARTHUR WILSON

Mr. Wilson. Thank you, Mr. Chairman for this opportunity to speak with you today.

My name is Arthur Wilson. I am the president of Local 898 of the Oil, Chemical & Atomic Workers International Union.

My local's membership consists of employees of the former Getty Refinery & Marketing Co.'s Delaware City Refinery, which is now owned by Texaco. I have been employed there for 23 years.

My 18,000 fellow employees and I are greatly concerned about the effect of pension plan reversions and spin-offs on the security of our promised pensions.

When a company such as Texaco is allowed to remove $250 million from a benefit plan without justifiable reason and with no recourse available to the employee, something is fundamentally wrong with the system.

Frankly, had a union official withdrawn funds from a pension plan, as corporations are permitted to do, the union official would have gone to jail, and well they should.

Our pensions are deferred wages. They are held in trust to be issued when we are deemed no longer desirable employees because of our age or infirmity. The deferred wages have been set aside and are not available to employees for any purpose except retirement.

For a company such as Texaco to be permitted to remove such funds, practically at will, is inconceivable and would appear contrary to all regulations for pension plans.

In early 1984, Texaco purchased the assets of Getty Refining & Marketing Co. for $10.3 billion. It took agreement of the board of directors acting on behalf of the stockholders' interests to approve the sale. On the other hand, pension plan assets, which we as employees share ownership in, are being treated quite differently. Employees' assets in the pension plan were sold without our agreement nor any input whatsoever from us as employees.

Prior to 1969 the Getty Pension Plan was a contributory plan. Many of my fellow employees have contributed moneys which are a part of the current plan assets. Texaco in its letter to employees of December 1984 announcing the spin-off alleged that the excess funds had developed primarily due to favorable investment returns. Yet the company has seen fit to pay only 3 percent per year on employees contributions through 1977 and 5 percent per year since 1978.

At the time our pension became noncontributory, I personally had approximately $1,000 in contributions in the plan. Today that money is worth $1,712. Sir, that same money invested in my Federal credit union today would be worth $2,700. If you extract that experience to my future retirement age, moneys held by Texaco will be worth $4,500. The same money in my credit union account would have been worth $12,500.

It is just not reasonable for a corporation to buy or sell assets which rightfully belong to the employees in this case. It is just not right to permit corporations to withdraw moneys from funds that were set aside and promised to secure our future.

In 1981 the company issued us a booklet called "Your Second Paycheck." In the first page in the introduction of that second paycheck, it says, and I quote: "If you look at all the benefits you receive from Getty's program, you can see it adding up to a second paycheck. Benefits may not be the same as cash in your hand, but they are just as valuable".

Speaking specifically to the pension issue, Getty said, and I quote: "During your working years with Getty, you can count on competitive pay and benefits." What happens, though, when your working career ends? Can you look forward to a productive and secure retirement? Or will you be facing hardship and uncertainty. Getty believes that the reward for years of hard work should be retirement years of comfort and stability.

We certainly agree.

At a time when Social Security is not all that secure and President Reagan has stated that we should not be dependent on Government social programs, reversions on pension plans just should not be permitted. ERISA, the program that was supposedly designed to secure private pension plans, has apparently opened up opportunities for abuse. The promise to pay in the future has been jeopardized rather than guaranteed as originally intended.

The purchase of annuities is a cleverly disguised effort to transfer moral responsibilities a corporation has to its long-term employees to a third totally disinterested party. We have no assurance that these annuities are guaranteed. A third-party insurance company holding such an annuity will have no moral responsibility to us and no incentive to grant cost-of-living increases.

As our Congresspersons, you have been vested with the power to protect us from those things which we are not able to protect ourselves. Our retirement is not secure under current conditions. In the interest of 18,739 Getty employees past and present, along with nearly a million of my fellow Americans, you must act to stop these pension plan reversions.

Mr. Clay. Thank you.

Mr. Smith?

STATEMENT OF DUDLEY B. SMITH

Mr. Smith. Thank you, Mr. Chairman and members of the select committee.

I am Dudley Smith. I was a middle management employee of Celanese Corp. for 17 years, retiring in July 1981.

I submitted a copy, Mr. Chairman, of my speech, so I will not repeat it entirely.

Mr. Clay. It will be in the record as you presented it.

Mr. Smith. Thank you very much, Mr. Chairman.

I do have a point which has not been brought up today, which I don't think anyone has focused on here, and which I don't think

Senator Metzenbaum addressed, particularly judging from the questions of Congresswoman Meyers and Congressman Fawell, who are members of my party. I am a Republican and was a Republican committeeman for 17 years in White Plains, NY.

I would like to explain the manner in which pay is calculated at Celanese. That is, about two-thirds of your pay is given to you twice a month as a salary and about one-third of it once a year as what they call a bonus. It should not be called a bonus. It is a way of keeping you in line. If you dress right, mind your manners, and in no way rock the boat, your bonus is pretty big. Management will not tell you how it is calculated nor the formula by which it is calculated. However, we are told that it varies with our performance and with the profits of Celanese Corp.

I would like this committee to consider for a moment Celanese. They terminated their pensions and sent me a form letter with a printed signature. Then they wouldn't return my phone calls, nor would they give me a list of those to whom this same letter was sent so I could try to rally together a force of Celanese retirees.

It is pretty tough, by the way, Mr. Chairman, when you find that your hero corporation, whom you have loved all these years—actually, I risked my life once for them—has feet of clay. I mean is my hero which has feet of clay.

Now let me tell you how I think this may be criminal. That is, what management did with the $326 million which they retrieved from our pension system. They have put it back in the company for, "general corporate uses." And when I said on the telephone to a man whom I would rather not name—as it will get him in hot water as he still works there—I said: well, now that you've recaptured this, were you going to spend it on things which include bonuses and pay raises, particularly for the top officers and managers with whom I worked for those 17 years? And he said: yes, it is, but don't quote me on that.

Now, imagine you have $326 million. The profit increases the recapture year markedly. All those corporate bonuses go up. Yet, I thought those people still working at Celanese—including the pension supervisors—were not supposed personally to benefit from this money. They have taken our funded pension money back, and it's now in their pockets.

We can't do anything about it without congressional help. Please help us. Thank you.

[The prepared statement of Dudley Smith follows:]

PREPARED STATEMENT OF DUDLEY B. SMITH

Mr. Chairman and members of the Select Committee: I was a middle management employee of Celanese Corporation for 17 years and retired in July 1981. During my first 3½ years, the pension plan was contributory. In January 1969, it became noncontributory.

To understand the thinking of Celanese top management and to place their machinations under ERISA in proper perspective, one first must understand and appreciate how middle and top management executives are paid. About two-third's of such an individual's pay is in the form of a twice monthly salary check and one-third is in the form of what euphemistically (and erroneously) is termed a "bonus" paid in one lump sum each spring. No one except a top few officers are told how or to what formula the "bonus" is calculated except that everyone is told it varies with corporate profit and will vary proportionally to the "grade" one receives at an annual performance review with the boss (immediate supervisor). If, for example, one urges Celanese hire more minorities or contribute more to support the lunch room or adopt a dental plan or not to terminate for no cause about one-third of the middle management people every 5 years or so (the "revolving door" policy for which I now realize Celanese is world famous), one's grade is LOW, hence the "bonus" low. Contrariwise, if one conforms to the mold, doesn't rock the boat, butters up the boss, wears only dark suits and conservative ties, and addresses the officers only by their last name, one's grade is HIGH hence the "bonus" is high! The bonus plan presumably keeps salaries low and pensions as well since pensions are based on salary per se i.e. not on the total of salary plus bonus.

I suggest we pause here a moment and ask ourselves, where is the 280 million dollar Celanese "ERISA serendipity" money going to be spent? My conclusion is that most of it will or has gone to the top officers as greatly increased bonus payments. Do the Members of this Select Committee agree this is a proper result?

About two years after my retirement, Celanese sent a printed form letter with a printed signature saying the pension plan was "overfunded" and thus terminated. In its place, retired employees would receive an annuity. In point of time, this occurred soon after the annuity selling insurance subsidiaries of Baldwin-United filed for bankruptcy. I thus was alarmed and wrote Celanese, the Department of Labor, and the Internal Revenue Service and a few other retirees whose addresses I had. Celanese did not answer any of my letters on this subject nor would they provide me with a list of other retirees. I had in mind forming a group of retirees so we could share the cost of making our views known. I then called Celanese several times and was able verbally to plead my case to the Vice President, Kenneth G. Anderson, who was chairman of the Celanese Employee Benefits Administration Committee and to one of the lawyers familiar with retirement matters. I had retired under the best of conditions (several officers and managers had pleaded with me to stay and my department hired 2 men to take over my work when I left). Also, I considered Mr. Anderson and the lawyer to be friends I could trust.

To my surprise, the answers given me on the telephone were supercilious and contumelious. I was told that the acturial present value of all pensions for all retired persons was 135 million dollars yet the market value of all assets was 415 million dollars. The difference, 280 million dollars (actually 326 million dollars according to yesterday's Wall Street Journal), was to be "recaptured" and used for "general corporate purposes". I asked if that included bonuses and pay raises for the top officers and managers and was assured it did. I protested as best I could that:

1. Retirees surely feel their pensions were much more safe with the 326 million left as a buffer rather than dissipated;
2. Celanese always had been more conservative actuarially and thus a safer haven than annuity sales entities such as Baldwin-United;
3. Fixed annuities never would grant retirees any cost of living raise or any inflation protection whatsoever;
4. The 326 million or a large share thereof was not contributed by Celanese but rather was generated by the rise in interest rates and fortuitous investment in the bull market in stocks;
5. This termination was not caused by any Celanese business necessity, but rather by pure management greed and an obvious effort to enrich and to entrench current corporate management;
6. Retirees at least should be given a public hearing so we could make our views known;
7. If indeed Celanese top management viewed the 326 million as mere "found money" (ERISA serendipity) why didn't they use at least a portion thereof to fund annuities with some built in inflation protection rather than fixed annuities; and
8. Celanese should feel a fiduciary obligation toward the so-called ERISA serendipity 326 million which obligation and conservative posture they themselves propounded year after year while we, the retirees, were actively employed at corporate headquarters.

All of the above, of course, was to no avail. Correction of inequities of this sort thus must be left to you, Members of this Select Committee.

Thank you for your time.

Mr. **Clay**. Thank you.

Mr. Penley.

STATEMENT OF PERCY PENLEY

Mr. **Penley**. Honorable Members of the House of Representatives, it is a privilege and honor to be able to share my views with you and to participate even in a small way in the legislative process.

While I am concerned personally, I am also concerned in principle with the spinoff and termination of a pension plan, the Celanese Retirement Income Plan.

To give you some brief background information, I was employed at Celanese's first chemical plant in Texas in June 1948, right after graduation from the university. I was 24 and the GI bill had helped me to convert from a combat infantryman to a brand new engineer. During the next 35 years, I had a series of interesting positions with increasing responsibilities in Texas, West Virginia, New Jersey, New York, Kentucky, and California, relocating my family a total of seven times. My last assignment was general manager of a Celanese subsidiary company, coating farm seeds in California.

In 1982, my corporation was going through some trying economic times, closing down facilities, laying off employees, and offering entire business units for sale. Early retirement incentives were offered to employees over 55 with many years of service. The offer sounded generous. I knew the pension fund was in superb financial condition, and I knew my operation was for sale.

I accepted the offer in August for retirement date of October 1. I worked for 6 months more at Celanese option. I retired April 1, 1983, and continued on the same job as a self-employed consultant until September 30, 1983. In October 1983, the corporation announced the pension plan was to be restructured, purchasing annuities for retirees, terminating their plan, and keeping about half of the pension fund's assets for Celanese.

This disturbed me. To start with, I felt I had been lured into early retirement while a plan was already under way to change the ground rules long before I retired. In the second place, the insurance company to sell the annuities just might be another Baldwin-United.

Also, I had contributed the maximum amount allowable to the fund from the first day I was eligible in 1953 until December 1968, when the plan became noncontributory.

Some $8,821 plus accrued interest of $1,467 had accumulated by then, and I felt that any inflation in the pension fund portion represented by my contribution should belong to me, if the rules were being changed.

Then I reasoned that no insurance company would be under obligation, either legal or moral, to increase pension benefits to retirees at any time in the future. Celanese had at least done that a couple of times in the past when inflation took its inevitable toll on fixed retirement pensions, I wondered how a corporation could take all the benefits of past inflation from a pension fund that was created, for the exclusive benefit of its employees, and leave retired employees to assume all the risks of future inflation.

Next I wrote off to get some offered additional information from Celanese Employee Relations. I became downright irate when I found that continuing employees were to get greatly improved pension terms, funded by money I thought was proportionally mine for 35 years. And I mean greatly improved, a 10-percent increase in the multiplier factor, removal of the 35-year maximum limit to years of credited service, an extra $300 a month from retirement date until eligibility for Social Security, and no reduction of benefits for early retirees.

Just Friday, for the last straw, I learned that the retirement medical insurance premium I pay is being increased 8.6 percent while my deductible is being doubled.

It might be easier to understand if the corporation needed to dip in the pension fund to survive or to save jobs, but using pension fund assets to buy golden parachutes, to purchase Celanese stock, to pay bigger executive bonuses, and I might insert, to fund an even larger executive retirement plan or to start still another stock option plan somehow seems obscene. People who retired some years ago are now getting a pittance for a lifetime of service. Is this right?

While I may not be competent to know whether the whole spin-off and termination maneuver is legal and/or within the intent of the 1974 ERISA pension law, I do know the difference between right and wrong in keeping faith with employees. There is something wrong with the system when those changing the rules profit from the changes, while those who are hurt have no recourse. Only you people can change the system; in fairness, I hope you will.

The time very well has come to consider indexing private pension plans in a way similar to Federal retirement plans and Social Security. To the corporations who contend that it will be too expensive, I just say, "Be creative." Corporations have become most creative recently when it benefits themselves.

Thank you for this chance to express my views. I will be glad to answer any questions you might have.

Mr. CLAY. Thank you.

Ms. Friedman.

STATEMENT OF KAREN FRIEDMAN

Ms. FRIEDMAN. My name is Karen Friedman and I am education director of the Pension Rights Center, a nonprofit group that works full time to protect the pension rights of workers, retirees, and their families.

Today we have heard from people who have been hurt by reversions. At the center, we have files full of letters from people who have been hurt, retirees and employees are outraged that this practice is allowed to continue. I would like to share some of these examples with you.

Senator Metzenbaum mentioned the Raymond International Co. as an example of a major reversion. We heard from a retired executive from Raymond. His name is Jean Bush. Although he spent 32 years with that company, will never get a cost-of-living increase. He is outraged about this because while his company is able to take back $30 million in surplus, the retirees, who he feels very strongly were the ones who built that fund, will not end up with anything. Although their cost of living has skyrocketed, their monthly benefits will always remain the same.

We heard from Mr. C, a retired executive from Firestone, who says that he is fuming mad that while the fund is bloating from the aftermath of inflation, retirees' pension checks are shrinking for the same reason. As he sees it, pensions aren't gifts, but are earned by the hard labor of all the employees working together. He feels very strongly that if a surplus exists, retirees should be getting a share.

Cost-of-living increases are a necessity if a retiree is going to live comfortably. If mandating automatic COLA's for all plans isn't yet feasible, there is no reason for not enforcing inflation protection in cases where plans are overfunded.

Of course, retirees aren't the only ones hurt by these reversions. William Canter, of the Simplicity Pattern Co., is proof that active employees, too, suffer drastic losses in reversions. Mr. Canter worked 38 years as a printer for the Simplicity Co. He always felt secure in the pension plan. In fact, he thought he had reason to. Every year, employees would receive a notice from the plan saying that the plan's funds would never be able to revert to the employer.

Mr. Canter had no reason to doubt the plan's integrity. But in 1984, that all changed. The plan filed to terminate and recapture $10 million. Mr. Canter, who expected to work until age 65, was frozen at the pension amount he had earned at age 57 when the plan terminated.

Let me show you what that means. If the plan had continued and Mr. Canter had been able to work until 65, he would have gotten a pension of $800 a month—certainly what he deserves after almost four decades of work. Instead, Mr. Canter's benefits were cashed out at $35,000, a figure that an acturary estimated would buy an annuity of about $300 a month at age 65. That is a $6,000 loss a year.

Vi McAllister also has first-hand experience in how workers get hurt when plans terminate. McAllister has been Superior Oil's plan administrator for the past 17 years and she feels that the Superior plan has always treated its participants well. But now that Mobil has taken over Superior, she thinks the employees got the raw deal. She says: "It is plain wrong that Mobil could take over the company, terminate the pension plan and then recapture well over $250 million in funds they had no part in earning." The real tragedy is that after the merger took place, some 1,400 Superior employees were laid off. She says these were the people who built the company, made it profitable and an attractice takeover target. But then the money in the pension fund, which the workers and retirees helped build up, is now paying for the acquisition that cost them their jobs. This is immoral.

Congress should pay close attention to the growing number of companies that are using pension funds in this way to acquire other companies or ward off hostile takeovers.

To address some of the points made today: If reversions were prohibited, then this incentive for takeovers could be diminished.

McAllister told us about a 61-year-old woman whose benefits were frozen when the Superior plan was terminated in December 1984. If the woman could have waited until the following July to retire, she would have gotten an extra $444 a year. Now, this may not seem like much, but multiplied by her life expectancy, the woman will lose $10,000 that she would have collected over a lifetime. You certainly can't say she hasn't been hurt.

Then there is Mr. L., from a book publishing company in New York. He tells how his company terminated the plan, recaptured funds and didn't even put in a new plan. He said the company had given the employees all the information on the successor plan, but it was never set up.

Mr. L. puts it well. He says reversions will make the system very unstable. He is quick to add that if confidence in pension plans erodes and the system falls apart, it is not going to be upper management, but the rank and file who will be hurt. They are the ones who can't afford to save and must rely on the pension system as their only supplement to Social Security.

Most of the people we hear from on reversions are relatively sophisticated, since they are the only ones who can decipher the complex termination notices and understand how revisions are going to affect them, but most of the victims of reversions don't even know what is happening until too late.

I talked to a security guard of a company in South Carolina who said that when he was told about the termination after being called down to his supervisor's office—this was already after the termination had been completed and the plan had been reverted—it hit him like a ton of bricks. At age 51, with 19 years of service, he learned that his pension would be frozen at that point.

The Pension Rights Center hears continually from people in the kinds of situations I have described today. People write us because they feel helpless and they want to know how to stop their companies from terminating and raiding their plans. The only hope is that Congress will act now to put an end to reversions. I heard that an executive from a major company recently predicted that if reversions aren't stopped now, there won't be any private pension plans left in America in 5 years. That can't be a policy that we are striving for.

We hope you will act to put an end to this problem before it is too late.

Thank you.

Mr. Clay. Thank you.

Mr. Siedman.

STATEMENT OF BERT SEIDMAN

Mr. Seidman. I am Bert Seidman, I am the director of the department of occupational safety, health and social security of the AFL-CIO. On behalf of the AFL-CIO, I wish to thank you for the opportunity to present our views on H.R. 2701, the Plan Termination and Reversion Control Act of 1985, introduced by Chairman Roybal and his cosponsors.

We commend Chairman Clay for holding these hearings and Chairman Roybal for the leadership he has shown on this issue.

In 1984, the AFL-CIO executive council adopted the statement on the corporate misuse of pension funds, which is attached to my statement. In the face of administration inaction, it called for congressional action to protect the rights of pension participants and I respectfully request that the executive council statement be made a part of the record of these hearings.

Mr. Clay. Without objection, so ordered.

Mr. SEIDMAN. Mr. Chairman, the AFL-CIO is greatly troubled by the increasing trend by employers to terminate so-called overfunded defined benefit pension plans for the sole purpose of securing what they call "excess assets." In our view, the employers involved are breaking their pension promises and diverting what is rightfully workers' money to other uses.

We are, of course, very glad that the United strike has been settled, but we found it particularly shocking that United Airlines has taken nearly a billion dollar from its employees' pension fund, and when it was announced, it certainly appeared to be for the purpose of financing its efforts to break the pilots' strike.

Workers generally lose major pension benefits when these kinds of terminations occur. They lose future benefits which would have been earned through future service with the employers, as we have heard so eloquently in the last few minutes. The result can simply wreck a worker's retirement security.

In many cases, the defined benefit plan is replaced by a defined contribution plan. Defined benefit plans provide far better retirement income protection. A defined benefit plan can recognize service with an employer prior to the start of the plan; can provide specified benefits with less risk to the employees; and can protect the employees against inflation during their working lives. Defined contribution plans do none of these things.

A pension plan is not a conditional or discretionary gift by the employer; rather, it represents current wages witheld to pay a benefit on retirement. The amounts contributed by the employer to the fund should, therefore, be an irrovocable payment which the employer cannot withold or recapture. Yet, as of March 31, 1985, U.S. corporations, if all pending terminations receive regulatory approval, have received transfers from pension funds of so-called excess assets of at least $6.2 billion since 1980, and of course, it is more than that today.

In addition, there are over 2,700 defined benefit plans with actuarial surpluses of over $1 million, all of which are potential targets for further termination reversions.

In ERISA, Congress provided employers favorable treatment for pension costs to encourage those employers to establish and maintain pension plans. Termination for the sole purpose of capturing excess assets is an abuse and is clearly contrary to this social policy.

Unfortunately, Federal agencies have been slow to take any action. It took many months of squabbling before the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation could decide on a policy, but the essence of their guidelines is to allow employers to continue to appropriate so-called excess assets.

H.R. 2701 would effectively deal with these abuses. It requires that plan sponsors terminating an overfunded pension plan must meet a business necessity test. That is, the termination must result from bankruptcy, insolvency or other business hardships before the employer is allowed to recover excess plan assets, less a 10-percent excise tax.

If the termination does not meet that test, the excess assets will be apportioned to retirees and workers within 5 years of retirement. H.R. 2701 also has a number of additional provisions detailed in my statement to protect workers and retirees against termination abuses.

We suggest one modification in H.R. 2701. Clearly, excess assets should go to retirees and workers nearly retirement, but active workers not within 5 years of retirement suffer pension benefit losses when a plan terminates. The bill should, therefore, be modified to permit them to share on a pro rata basis in any excess assets when a plan terminates.

Congressional consideration of legislation to resolve this admittedly complex problem may take time. In the interim, as we can see, the wave of terminations will continue as unscrupulous employers attempt to grap pension assets before Congress acts. We, therefore, call for an immediate temporary moratorium on the processing of these kinds of terminations until Congress can carefully craft legislation to resolve the problem.

We commend you for holding this hearing and will be happy to work with you on this important issue. Legislation to deal with termination abuses is vital and should be enacted into law as soon as possible.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Seidman follows:]

PREPARED STATEMENT BY BERT SEIDMAN, DIRECTOR, AFL-CIO DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY

On behalf of the AFL-CIO, I wish to thank you for the opportunity to present our views on H.R. 2701, the Plan Termination and Reversion Control Act of 1985, and to express our views on ways to deal with the abuses caused by widespread termination of overfunded defined benefit plans which results in benefit losses to retirees and workers. We commend Chairman Clay for holding these hearings and Chairman Roybal for the leadership he has shown on this issue.

In 1984, the AFL-CIO Executive Council adopted a statement on the corporate misuse of pension funds related to the termination of overfunded pension plans. A copy of this statement is attached to this testimony, I respectfully request that it be made a part of the record of these hearings.

The AFL-CIO is greatly troubled by the increasing trend by employers to terminate so-called "overfunded" defined benefit pension plans for the sole purpose of securing what they call "excessive assets". When the plan is terminated, annuities are purchased to cover the obligations for vested and retired employees and the excess is recovered by the employers. A variation is a spinoff termination in which a pension plan is split into two parts—one for active employees and one for retirees—and the excess assets are allocated to the retiree plan. The latter plan is then terminated, annuities are purchased to cover the accrued liabilities and to pay benefits, and the surplus is taken by the employer. In both cases, the employers break their pension promises and divert what is rightfully workers' money to other uses.

Workers generally lose major pension benefits when these kinds of terminations occur. Even though their pension benefits are vested and accrued to the termination date, they lose future benefits which would have been earned through future service with the employer. Even if the employer replaces the terminated plan with some kind of new pension plan, the worker is unlikely to achieve the benefit level provided by the terminated plan. The result can wreck a worker's retirement security.

A recent Department of Labor study indicates that a typical worker involved in the termination of an overfunded defined benefit pension plan lost $45 out of every $100 in expected benefits. In addition, ad hoc inflation adjustments for retirees are out of the question when both the surplus and plan are gone.

In many cases, the defined benefit plan is replaced by a defined contribution plan. Though some experts may not agree, the prevailing view and certainly that of the labor movement is that defined benefit plans are a better and safer way to provide retirement benefits for workers. There are certain major features that account for this choice. A defined benefit plan can recognize service with an employer prior to the start of the plan, can provide specified benefits with less risk to the employees, and can protect the employees against inflation during their working lives by relating benefits to wages at the time of retirement. Defined contribution plans ignore prior service, place the employee at risk since benefit amounts will depend upon investment performance, and cannot adequately protect workers against inflation during periods between start of work and retirement. Thus, reversions nearly always undermine or eliminate defined benefit plans which provide workers with better retirement protection.

When a pension plan is included in a collective bargaining agreement, both parties explicitly or implicitly acknowledge that it is, in fact, a part of the wages and conditions of employment which workers are to receive in exchange for the labor. It is not free and workers to not get something for nothing. They earn it.

A pension plan is not, therefore, a conditional or discretionary gift by the employer. Rather it represents current wages withheld to pay a benefit on retirement. To many, the fact that a retirement plan is a form of compensation may seem too obvious to require further argument. Nevertheless, it is a point worth remembering and emphasizing. It has a very important bearing upon many questions which are bound to arise with regard to the right of workers under a pension plan.

Since the employer contributions paid into the fund have been earned by workers, they actually pay the full amount of the cost. The amounts contributed by the employer to the fund to finance the pension credits accumulated by each worker should, therefore, be an irrevocable payment which the employer cannot withhold or recapture just as an employer cannot withhold or recapture cash wage payments.

The latest figures compiled by the Pension Benefit Guarantee Corporation, as of March 31, 1985, show that U.S. corporations (if all pending terminations receive regulatory approval) have received transfers from pension funds of so-called excess assets of at least $6.2 billion since 1980. The Internal Revenue Service estimates that, in addition, there are over 2,700 defined benefit plans with actuarial surpluses of over $1 million—all of which are potential targets for further termination reversions.

It is most unfair for an employer to take advantage of a temporary and unique economic situation of unusually high interest rates to terminate a pension plan. Congress passed ERISA and provided employers favorable tax treatment for pension costs because it was thought good social policy to encourage employers to establish and maintain pension plans. Termination for the sole purpose of capturing excess assets is an abuse and is clearly contrary to this social policy.

Unfortunately, federal agencies have been slow to take any action. It took many months of squabbling between the Department of Labor, the Internal Revenue Service and the Pension Benefit Guarantee Corporation before they could decide on a policy. The essence of their guidelines it to allow employers to continue defined benefit coverage for their workers and to take the so-called excess assets since the employer is permitted to set up a plan identical to the one terminated. It is unlikely anything would have happened except for the unusual combination of pressures from organizations, members of Congress and the media.

The Administration's guidelines are unsatisfactory in a number of respects. For example, they do not require a cushion of assets to be left in the fund to protect against adverse economic and investment fluctuations that could result in the accrued benefits being less than fully funded. The guidelines also ignore the problem of inflation adjustments for retirees and lack any requirement that past service credits from the previous plan must be carried forward for the participants in the successor plan.

The most serious defect is the probability that the guidelines are based on shaky legal assumptions and, in the opinion of many knowledgeable lawyers, can be successfully challenged in the courts. In short, it is not possible to achieve satisfactory protection for workers with respect to termination abuses within the limits of present law, and, therefore, legislation is required. More effective action must be taken soom since growing numbers of employers are terminating their pension plans in order to capture so called excess assets to the great detriment of employees and retirees.

H.R. 2701 is a bill which would effectively deal with the abuses associated with termination reversions. This bill requires that plan sponsors terminating an overfunded pension plan must meet a business necessity test before being allowed to recover excess plan assets (less a 10 percent excise tax). The test is that the termination must result from bankruptcy, insolvency, or other business hardships. Quite properly, if the termination does not meet that test, the excess assets will be apportioned to retirees and workers within 5 years of retirement. An excise tax of 10 percent would be imposed on any remaining excess assets not distributed to workers and retirees. Only if the termination meets a business necessity test, is the employer allowed to recover the excess assets.

H.R. 2701 has a number of additional provisions to protect workers and retirees against termination abuses. For example the bill would:

Place restrictions on employer pension fund contributions in lieu of cash such as employer stock. Greater regulations and scrutiny are essential to ensure that such contributions by employers do not endanger workers' pensions.

Require a terminated plan which meets a business necessity test and establishes a comparable successor plan to provide benefits which are no less than those provided by the terminated plan, to credit past service, and to provide a cushion of assests to protect against adverse experience causing the underfunding of accrued benefits.

Require a vote by participants before a conversion of a defined benefit plan to an Employee Stock Ownership Plan (ESOP) can take place. Action is essential to deal with those abuses which take place in the context of leveraged buyouts or anti-takeover maneuvers where the employer resorts to an ESOP.

Require a public hearing on an application for "overfunded" terminations so plan participants can express their views on the pending temination.

Commission a study to make recommendations on whether standards are necessary for actuarial assumptions and methods for pension plan funding.

The AFL-CIO believes that H.R. 2701 would effectively deal with the problems arising from termination of overfunded pension plans. However, we suggest that it be modified on one respect. We recongnize that there are vaild reasons for gruaranteeing that the excess assets go to retirees and workers near retirement since the loss of assets effectively forecloses any future ad hoc cost of living adjustments. But active workers not within 5 years of retirement suffer pension benefit loses when a plan terminates and also should share in any excess assets when a plan terminates and also should share in any excess assets when a plan terminates. H.R. 2701 should be modifed to insure that other active workers share in the distribution of excess assets.

A major concern is that Congressional consideration of legislation to resolve this admittedly complex problem will take time. In the interim, the wave of terminations will continue as unscrupulous employers attempt to grab pension assets before Congress acts. Thus, an immediate temporary moratorium on the processing of these kinds of terminations is the best way to protect workers' pension funds and to allow the Congress the time necessary to carefully craft legislation to resolve the problem. This legislation would not interfere with legitimate pension plan terminations since these could continue so long as the facts and circumstances showed the plan termination resulted from business necessity. Once a moratorium is in place, the Congress would have time to carefully devise appropriate legislation to permanently resolve the problem.

It is becoming clear to all responsible persons with a stake in the private pension system that something must be done to deal with the abuses that are occuring with pension plan terminations and the reversion of excess pension assets. For example, editorials or articles by Business Week, Pension Investment, and Barrons have criticized these kinds of terminations and have called for action. John Erlenborn, former ranking minority member of the Subcommittee on Labor Management Relations and one of the architects of ERISA, has called for legislation. In short, the AFL-CIO is finding support from publications and individuals which generally oppose rather then support our positions.

Though individuals and organizations may agree that something needs to be done, we are aware that major disagreements exist concerning what specific actions should be taken. For this reason, though we would prefer for Congress to pass legislation along the lines of H.R. 2701, the AFL-CIO is not committed to any one approach. We are willing to work with all interested parties to design acceptable solutions and legislation. The objective should be a better private pension system based primarily on defined benefit plans. The AFL-CIO is prepared to fully cooperate in any efforts to advance that objective.

We commend the Subcommittees for holding this hearing and will be happy to work with you on this important issue. Legislation to deal with termination abuses is vital and should be enacted into law as soon as possible.

STATEMENT BY THE AFL-CIO EXECUTIVE COUNCIL ON CORPORATE MISUSE OF PENSION FUNDS

The Employees Retirement Income Security Act (ERISA) requires that those responsible for administering pension plans must act prudently and for the exclusive benefit of their participants and beneficiaries.

Nevertheless, a number of pension funds are managed in ways contrary to these objectives. Some employers have transferred stocks, bonds or other company assets to their pension funds in lieu of cash. Such non-cash contributions not made at fair market value and with restrictions as to their use or sale endanger the security of the pension rights earned by workers.

The growing trend among companies to terminate so-called "overfunded" defined-benefit pension plans in order to secure for the firm what they call "excess assets," and to use these assets that rightfully belong to workers' pension plans for their own benefit, is no less troubling.

A report of the Pension Benefit Guaranty Corporation disclosed that since 1980, 138 corporations have taken over $517 million from their employees' pension funds in "excess assets." Pension fund assets that could revert to employers total $1.8 billion if terminations pending and being litigated are counted.

The Internal Revenue Service estimates that more than 2,700 defined-benefit plans have actuarially projected "excess assets" of over $1 million, tempting growing numbers of employers to improperly manipulate plan provisions to divert pension fund assets to corporate purposes. Yet, the Department of Labor, the Internal Revenue Service, and the PBGC have taken no effective action to prevent such corporate raids on their pension funds, thus jeopardizing the retirement security of millions of American workers.

We call upon Congress to protect the rights of pension participants and to preserve the integrity and promise of the nation's private pension system.

Mr. CLAY. Thank you.

I might also state for the record that representatives from Celanese and Getty were invited to testify today, and both declined.

Mr. Seidman, I take it from your statement that you believe excess assets in a defined benefit plan belong to the workers. How would you respond to the argument—or how do you respond to the argument that because an employer will have to make up the losses in a defined plan if investment performance were poor—that employers should be allowed to reap the gain if good investment performance increases the value of the assets?

Mr. SEIDMAN. Mr. Chairman, the assets in the pension plan result from negotiations which take place between labor and management or, in some cases, a unilateral employer decision.

Unions negotiate those benefits in return for not obtaining other items in the bargaining package, whether it may be higher wages or a better health and welfare plan or whatever it may be. When they have negotiated a defined benefit plan under these circumstances, it becomes the responsibility of the employer to provide those benefits.

The funds result from the negotiation, the workers' sacrifice in order to bring it about. There is no basis on which the employer can then fairly turn around and destroy pension benefit protection both for active employees and for retirees.

Mr. CLAY. Thank you.

Mr. Roybal.

Mr. ROYBAL. Thank you, Mr. Chairman.

I would like to compliment the witnesses for their excellent statements. I am not going to ask questions of each one of you because of the time constraints, but I would like to point to the fact that we did, in fact, invite United Airlines and ALPA; and they both decided that they would not come to this hearing. United Airlines did send a communication that is now in the record.

I would just like to briefly summarize one paragraph that I read in that communication. This is their excuse.

> Therefore, we are taking this step so that outsiders who may be tempted to try a takeover of the company to obtain those excess assets in our pension program will clearly understand that they are not available.

In other words, they are saying, "You can't take them over because we are going to do it ourselves."

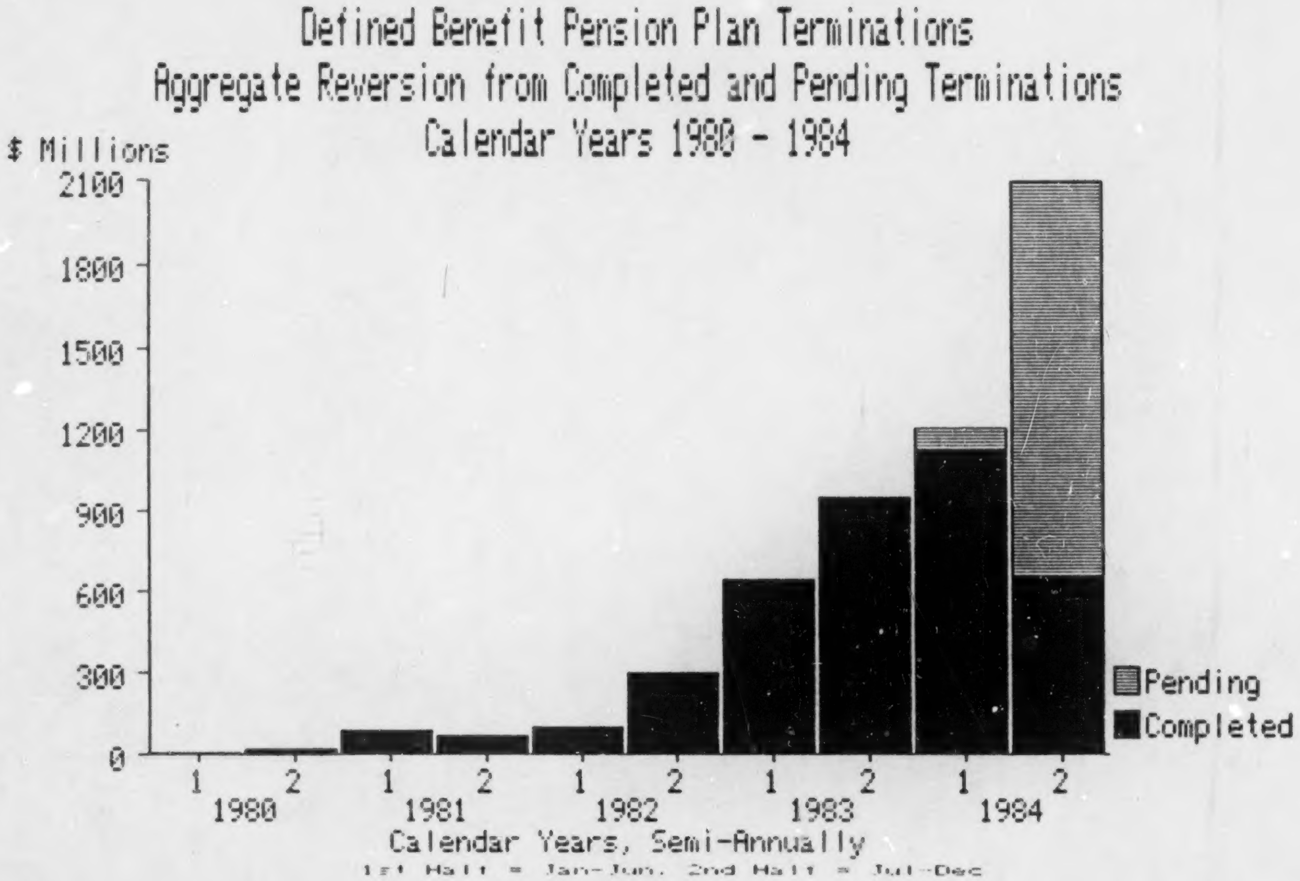
Then the next thing they say is: "United Airlines and its companies intend to maintain control of their funds for the benefit of their employees, their future and United Airlines shareholders."

I believe that it may be for the shareholders, but surely not for the benefit of the employees.

Do you agree with that?

Mr. **Seidman**. I certainly do, Mr. Chairman. There is no question in my mind that the employees under those circumstances do not have any protection and there was another course available to United, and that was to improve its pension plan. Those funds could have been used to improve their pension plans and then they wouldn't have been a target for takeover.

Mr. **Roybal**. The truth of the matter is that takeovers such as contemplated by United Airlines are most profitable, as indicated in the chart below.



Defined Benefit Pension Plan Terminations
Aggregate Reversion from Completed and Pending Terminations
Calendar Years 1980 - 1984

Mr. **Roybal**. In 1980, which is to the left side of the chart, there is hardly any action. The red that you see in the chart are takeovers that have been completed. To the extreme right, the blue line indicates those that are pending.

Now, that amount is $4.5 billion that has been taken over, having been completed from 1980 to 1984—it does not include this year in its entirety—and $3 billion that are now pending, a total of $7.5 billion.

That is a tremendous amount of money, affecting thousands and thousands of employees who, in my opinion, are being deprived of their investment and years of service.

Will you comment on that, Mr. Seidman?

Mr. **Seidman**. Yes; I would like to comment on it. I would like to state two things in particular. The first is that I believe that Senator Metzenbaum said there are two kinds of pension plans in this country. Many pension plans are administered solely by the employer; the employer has complete control over the operations of the pension plan; and then there are the so-called Taft-Hartley joint trusts, where labor and management jointly manage the pension plan.

I am quite sure that, of the pension plans represented on that chart, only a minuscule percentage involve those pension plans which are jointly trusteed. In other words, where labor has an opportunity to determine how the plan is managed and how it is operated, it is not going to be scuttled in the way in which the management-controlled unilateral plans have done so.

The second point is that all of this talk about excess assets is based on some very unusual economic circumstances which permitted the building up of these so-called excess assets, which are by no means assured in the future, and second, they are based on very tenuous economic and actuarial assumptions and, therefore, it seems to me, if there are additional funds, that those funds ought to be used to shore up the financial solidity of the funds and to make sure that the pension promise that they represent will, in fact, be fulfilled.

Mr. **Roybal**. Thank you, Mr. Chairman.

Mr. **Clay**. Mr. Rinaldo.

Mr. **Rinaldo**. Thank you very much, Mr. Chairman.

I want to get this a little bit in focus because I have some questions here that have been troubling me.

First of all, let me ask you a question, Mr. Seidman, to follow up on what you just said. Has the AFL-CIO taken any steps to encourage collective-bargaining between business and labor over the terms and conditions of pension termination and asset reversions?

In other words, what I am getting at, if all of this were locked up in a collective-bargaining agreement, we would probably avoid many of the problems that we see on the chart.

Mr. **Seidman**. The answer is yes, Mr. Rinaldo. The AFL-CIO established about 6 years ago a committee of its executive council on the investment of pension funds and after studying the whole question of the way in which pension funds in this country are managed and the way in which investment has been carried out, it made a number of recommendations, and among those recommendations to our affiliates was do what they could to try to secure a greater degree of control over those pension funds where, until now, they have been exclusively under the control of management.

A number of unions have acted to do that. Now, they have not been able to achieve the same level of joint control as in the building trades and in the retail industry and so on where we have Taft-Hartley joint trusts, but there is a definite trend in that direction.

Mr. RINALDO. Let me ask this: If you take the labor contracts by AFL-CIO unions throughout the country, in what percentage of those contracts are the terms and conditions relating to asset reversions and pension terminations embodied in a collective-bargaining agreement? Can you give me a percentage figure?

Mr. SEIDMAN. I don't know that there are collective-bargaining contracts which actually deal explicitly with that question. The trend, as I say, is instead to deal with it not in terms of collective bargaining, but to change the way in which the pension plan is set up so as to give the union a degree of participation that it has not had in the past.

Mr. RINALDO. Most experts believe that defined benefit plans represent the best type of retirement plan and they say that because workers are guaranteed a certain dollar amount at retirement. What concerns me is that any legislation that we might enact that would preclude or penalize reversion could be counterproductive and hurt workers in the long run.

At best, it would tend to cause employers to opt for less costly and less generous funding methods in order to reduce the buildup of plan surpluses. I think this might be a natural road for them to take. At worst, it could dissuade employers from establishing or continuing to maintain defined benefit plans and some companies have already taken such action.

Maybe the real answer is for the administration or someone else to get management and labor together to come up with the problems and possible solutions and maybe at this stage in the game, what we need—and I am only throwing this out for discussion purposes—is a task force, including members of the administration, members of organized labor, members of business. I recognize the problem and, as you know from my opening statement if you were here when I made it—I am 100 percent for taking action to curb the problem. But I don't want to take any action hastily that might, in the long run, result in businesses becoming reluctant to offer and continue such plans because controls are placed on what they may do with surplus assets.

This hearing is an excellent idea, but the issue is something we have to explore in depth. There are no easy answers. Do you think that is a possibility and what are your feelings about some sort of task force to come up with recommendations within a set period of time?

Mr. SEIDMAN. I am not in a position to tell you about what our recommendation would be with respect to a task force, per se, but I will assure you that we are ready to sit down and talk, not only to Members of Congress, but to member of the administration, and to management people about this problem. We are willing to sit down and talk to anybody about this and we are not necessarily saying that there must be legislation of a permanent kind enacted the day after tomorrow. We are very much concerned about what is going on and if there is going to be the kind of consideration which is going to take a long period of time, then we strongly urge that there be a temporary moratorium, as Congressman Roybal and Senator Metzenbaum had proposed in the last Congress, that there be a temporary moratorium on any further reversion until the long-term legislation is enacted.

Mr. **RINALDO**. Would any other member of the panel like to comment on——

Ms. **FRIEDMAN**. Yes, can I comment on your question about if we somehow ban reversions, whether or not this is going to discourage new plans from being set up?

Mr. **RINALDO**. Well, I said more than ban reversions. I said if——

Ms. **FRIEDMAN**. But in some way put restrictions on it.

Mr. **RINALDO**. Yes.

Ms. **FRIEDMAN**. The first point I really want to make, and it is a general comment, is that we have to put reversions into almost a historical perspective. It is a very recent phenomenon. Reversions have only existed in the last years.

In the past, companies never set up plans—and they still Do not set up plans—with expectation that at some point down the line, because of high interest rates and high inflation, that there would be surplus assets that they could charge in and take back. Pension plans are set up as permanent institutions for one purpose and one purpose alone, and that is to provide retirement income to workers and retirees. That was the reason that ERISA went through.

ERISA makes it very clear that that money must be used solely in the interests of workers and retirees. To address Congressman Fawell's point before, this money is workers's and retirees' money and the money should not be used except in the interest of workers and retirees. When ERISA went into effect, it tried to clear up many of the problems that existed before that time when employers could go and dip into the pension plan.

We are seeing a time again when pension funds are jeopardized for workers and retirees. The point that I am trying to make is that reversions are a whole new phenomenon and companies have set up pension plans in the past, and they are going to continue to set up pension plans, whether or not there are reversions.

All these fancy rationalizations that if employers aren't allowed to take back assets, they are going to not set up palns or whatever doesn't hold water.

Mr. **RINALDO**. You say that now, but you also say that it is a brand new thing and if you take a look at the chart, more and more companies are doing so I think it is natural to assume and it logically follows that if a company, for any reason, strongly favors a reversion or using the surplus assets for some other purpose, even to avoid a hostile takeover, in their opinion, you have to recognize that if there is legislation that is extremely restrictive, that they may then say, "Maybe we shouldn't have a pension plan."

I think it is very difficult to predict what is going to happen in that area. I don't know whether or not that is going to happen, but I don't think you can flatly dismiss it, either. I think to flatly dismiss it without any empirical evidence to back you up is treating the question a little lightly, in my view. I think it is something that you have to consider because we have passed—I have been here 13 years and I have seen a lot of legislation passed in my 13 years, where people say. "You don't have to worry about that problem," and all of sudden, you find a big problem as a result of the bill that is passed. It becomes very difficult then to amend it or change the law so that you go back to the former status.

Ms. **Friedman.** Well, one——

Mr. **Rinaldo.** If nothing else, it is something that should be carefully examined.

Ms. **Friedman.** We absolutely believe that it should be examined. One other point I would like to make is that since the administration issued guidelines—the guidelines were supposed to protect participants—there are companies that have terminated plans that we feel would not have terminated their plans if the guidelines didn't exist.

So, in some ways, the guidelines are encouraging more companies to stop their plans and revert the assets.

Mr. **Rinaldo.** Just one final question on that regard. One of the members earlier mentioned A&P. Do you think A&P would have reversioned the plan anyway?

Ms. **Friedman.** A&P started this trend. Companies like A&P are going to terminate their plans if there is a business necessity and that is always going to be the case; but the point that also needs to be made strongly is that companies are taking advantage of a loophole in the law that allows them to get access to the money by terminating the plan. So a lot of companies that aren't under any business necessity that wouldn't be closing their operations normally are now terminating very healthy plans just to get hold of these assets.

We feel if there were restrictions made on these reversions, then this would not happen.

Mr. **Clay.** The time of the gentleman has expired.

Mr. Biaggi.

Mr. **Biaggi.** No questions, Mr. Chairman.

Mr. **Clay.** Mr. Saxton.

Mr. **Saxton.** Thank you, Mr. Chairman.

When Senator Metzenbaum was here, I asked a question about the total number of individuals who were perhaps affected by the lines you see on the graph and they indicated—the Senator indicated that there could perhaps be as many as 1 million people. I guess a good follow-up to that question would be, of the total number of pension plans in the country, do you have some idea as to how many might be affected in terms of a percentage to date?

How many private pension plans——

Ms. **Friedman.** Oh, how many private pension plans have been affected to date? I think it is 500 private pension plans and the total assets that have been recovered are well over $6 billion at this point.

Mr. **Saxton.** Do you know offhand what percentage 500 pension plans might be of the total number of private pension plans that are in operation?

Ms. **Friedman.** I don't know that. I could certainly get that for you.

Mr. **Saxton.** Does 1 percent sound right?

Ms. **Friedman.** I am not sure.

Do you have any idea about that?

Mr. **Seidman**. I know the figure on assets. I don't remember offhand the number of pension plans that there are, but I would like to point out that while I am sure this is a very small percentage of the total number of pension plans that are affected, and only a relatively small percentage of total workers, nevertheless, it does affect some very large pension plans and large numbers of workers.

Mr. **Saxton**. I remember reading in some of the testimony that we are perhaps going to hear later that the percentage of the total number of pension plans that are currently affected is around 1 percent and I just wanted to verify that with you if I could.

Mr. **Seidman**. I have another figure which might be of some help to you, which does not directly answer your question. That is, there are 36 million workers covered by pension plans and 1 million of them have been affected. So we are not talking about huge percentages. It is not something which is being done by any large majority of pension plans, but it is something which is increasing rapidly and adversely affecting many workers who thought that they had built up a sound retirement income protection.

Mr. **Saxton**. Do you—I think most of us that are here today are here because we recognize there is a problem. We are with you in terms of that recognition—at least I am, and I think our next step is to try and decide what it is we each think we ought to be suggesting to do about this thing to solve the problem.

I guess one of the questions that needs to be asked, and one of the questions that we certainly need to get answers to is when a pension fund is healthy and has a surplus in it, to what degree do we want to impose limitations on the use of that surplus? Do we want to pass a law that says reversions are illegal? We can't continue the practice that we are doing now and just straight out say that. Do we want to further regulate the use of pension funds, as some States do in their public pension funds? Do you see, for example, any conditions under which surplus assets could be used by a corporation or a company or an employer? Do you see any conditions under which——

Mr. **Seidman**. As I have stated in my testimony, where there is real business necessity, or other situations such as where the employer is going out of business we think that a reversion might be possible, but we do not think that for healthy companies with pension funds in good condition, that we should allow the funds to be appropriated for the kinds of purposes that these gentlemen on the panel have been talking about.

Mr. **Saxton**. One final question. There are instances where people have lost their pensions, and of course, we are fortunate that we have the Pension Benefit Guaranty Fund today, which is aimed at preventing that from happening, but I can recall not many years ago one of the major industries in the Northeastern part of the country happened to be the production of steel and wire rope that was frankly used to test many of the bridges around the country and that company went bankrupt and many of the pension fund participants lost their pensions.

I think there are some instances like that when it would be to the benefit of not only the members of the pension fund but also to the company itself to maintain a degree of flexibility in our laws or in our regulations relative to those kinds of situations which do occur. It may be a difficult business situation or it may be in the instance of a threatened takeover or some other type of situation where there are extenuating circumstances where some type of reinvestment in the company might be warranted. I think that that is one of the things that we need to be very, very careful of.

Mr. SEIDMAN. If that kind of thing is going to be permitted, it ought to be subject to collective bargaining where there is a union so that the employer could not do this on a unilateral basis. Second, where there isn't a union, unless we very carefully restrict it so it is not abused——

Mr. SAXTON. Mr. Chairman, I thought that was my last question, but the subject of collective bargaining intrigues me and I am curious. I believe Congressman Rinaldo suggested that there is currently the opportunity for collective bargaining on this subject. Is that not so, and if it is so, is it being diligently pursued by the AFL-CIO and other organizations?

Mr. SEIDMAN. Provisions of collective-bargaining agreements relating to this problem vary a great deal and often are inadequate. It is not the subject of collective bargaining except at the time when the negotiations are timely. I mean, in other words, you can't bring a subject of that kind up at any time. At the present time, the law permits this kind of unilateral action on the part of employers and some employers are taking advantage of this. I think that unions, having seen what employers are doing, will be very much more likely than in the past to try to raise these questions in collective bargaining.

Mr. CLAY. The time of the gentleman——

Mr. RINALDO. Will the gentleman yield for just——

Mr. CLAY. Yes.

Mr. SAXTON. Certainly.

Mr. RINALDO. The point I was trying to make, and I think that Congressman Saxton is very aptly following up on, is that it wouldn't take legislation on our part to enable your unions to get out, and when a contract expires, they have the authority under the National Labor Relations law to negotiate the terms and conditions of any reversions or pension agreements that they want to be made part of that agreement. They can include that and put it on the table.

Mr. SEIDMAN. I suppose we could have negotiated to get the kind of arrangements that the Pension Benefit Guaranty Corporation has made possible, too, but there is a limit to what can be done through collective bargaining——

Mr. CLAY. If the gentleman would——

Mr. SEIDMAN [continuing]. And where there is a clear abuse, we look to the Congress for the righting of abuses. We don't think that it should be the burden of collective bargaining to deal with every situation.

Mr. RINALDO. I am not saying——

Mr. SEIDMAN. The employer may be very much stronger than the union in many circumstances and to leave this to collective bargaining, it seems to me, is to, in effect, shunt away an adequate solution to the problem.

Mr. RINALDO. Mr. Chairman, if I may, just to clear up the record.

I am not saying to leave it to collective bargaining. I am saying that legislation may be needed and I would support appropriate legislation, but what I am saying is that it is a relatively new phenomenon and you seem to accept Ms. Friedman's statement in that regard, and if so, I think that it would behoove the AFL-CIO to have their respective unions include that as part of the collective agenda when contracts expire.

Mr. SEIDMAN. Well, as you know——

Mr. CLAY. The time of the gentleman has expired.

Mr. Hayes.

Mr. HAYES. Thank you, Mr. Chairman. Having been one who has had the privilege of being involved in the process of collective bargaining before and after ERISA, I must say that collective bargaining is not the complete answer to the problem we are discussing now. There has to be legislation, I think, some definite legislation.

Another dimension—maybe it doesn't even come before this committee—that I want to find out if Mr. Seidman agrees with my position. There seems to be great consolidation of corporate wealth into fewer and fewer hands. When General Motors, without even the need of funds from its pension fund, can acquire Hughes Aircraft for the purposes, in my opinion, of eliminating competition of getting into that field and at the same time, you will find other companies acquiring and moving into new fields and using pension funds in order to do it, it certainly signals the need to me for closing up these loopholes.

My specific question is, if you agree with my assessment, do you see a circumvention of ERISA on the part of some of the moves that are now being made by corporations having been one who negotiated contracts when employers permitted themselves to make contributions into pension funds, ana yet—and now to cure what they call "vested" pension rights for their employees, and yet they filed bankruptcy and went out of business and found out that they hadn't even made contributions into the fund to the tune that they were supposed to.

My specific question is, in relation to that, ERISA was supposed to close this loophole, at least a guarantee that a person's vested pension rights after 10 years of service or something of that sort. Now we find that people are not, by these acquisitions, getting what they are entitled to, even after having passed a continued part of the question of vested rights.

Do you see this as a mechanism of circumventing that is now being used and these loopholes need to be closed through legislative action?

Mr. SEIDMAN. Let me just say, first of all, that I am not a lawyer, and therefore, I am not in a position——

Mr. HAYES. Neither am I.

Mr. SEIDMAN [continuing]. But let me go on to say that as a layman, it would appear to me that these kinds of employer actions are violations of their fiduciary obligations.

Second, these actions are not consistent with the spirit and policy of ERISA but I can't really comment with any assurance as to whether, in fact, their actions can be construed to be in accordance with the letter of the law, but certainly they are not with the spirit of the law, and certainly not with what I would consider a true fiduciary responsibility.

Beyond that, if, indeed, there is this loophole, then I think it ought to be closed and I think it ought to be closed along the lines of the bill which has been introduced by Chairman Roybal.

Mr. **Roybal** [presiding]. Ms. Friedman.

Ms. **Friedman**. I will just add a few comments.

One is, I think when companies terminate their plans and recapture the assets, they are fulfilling an obligation more to their stockholders than they are to the participants in the pension plan. I, too, am not a lawyer, however, I do know that, yes, employers are circumventing the law by taking advantage of a loophole that permits them to get away with reversions. It is only because of that loophole that companies are doing this. I agree with Mr. Seidman, they are violating the spirit of ERISA if not the letter, and we think that it is time for Congress to act and put an end to this practice.

Mr. **Roybal**. The time of the gentleman is expired.

The Chair recognizes Mr. Fawell.

Mr. **Fawell**. Perhaps these are more comments and I will try to keep them brief.

As I follow the conversations here, the comments, the tendency for those who are testifying is to assert that there should be basically removal of the right to terminate. I came from a small law firm. We went defined contribution because we couldn't possibly assume the risk of defined benefit, and I think most of the small employers in this Nation do the same thing, defined contribution. They can't think of defined benefits, which undoubtedly is the best for the employee. There is no doubt about that, and I think probably few employees have that kind, except the very large corporations.

But there won't be any takers, I don't think. I think you will kill the goose that laid the golden egg because if you are told—if you can't terminate or, as one gentleman said, until you get near bankruptcy or insolvency, I don't believe you are going to find many people who are going to take that kind of a risk. The one out they have now is the fact that when a lawyer is talking to them about their plans, they will say, "Now, you can terminate," and it should be, I think we are saying, based on sound business reasons. It ought to take a sensitive view of the employees. That is what we deplore and would like to get at the root of somehow but I don't think anybody is coming up with that handle to do it. Even the unions have indicated that, it has been a hot topic for us. We have done nothing on it. We have sat by and let this kind of grow, also.

It seems to me that when there are sound business reasons—and there are—sometimes a corporate board can say, "We are going down the drain. We have to get some of this money back. We have got to rebuild and that is going to help everybody, future employees, present employees and those that are retired."

It seems to me that we are moving toward this idea of having some restrictions, but based upon sound business reasons and evaluation, the concept that you just can't terminate. Then you terminate the whole concept. I don't think people will go into it.

Mr. **Roybal**. Mr. Smith.

Mr. **Smith**. Congressman Fawell, I would have a question for you. Why couldn't Celanese have purchased (when they were purchasing annuities) the type of annuity which protects retirees at least in part against future inflation and used part of—a very small part is all it would take, of that $326 million and they could have purchased that kind of an annuity? Instead, they bought the cheapest kind of annuity available.

Now, I don't think that is fair nor proper and I hope you will find it is illegal, too.

Mr. **Fawell**. May I say, I would agree with you. If you are in a situation where Celanese was perhaps in and they could have a annuity that would have taken into account COLA's, that would seem to me to be the moral thing to do. On the other hand, if you were to tell employers that they had to build in COLA's, and that they had to build in a protection which I think is more of a problem—the other gentleman, Mr. Penley, I believe, referred to as the "frozen accrual" for employees who had 15, 19 years. They suddenly find, yes, they will get in now vested form what is accrued, but the next plan that they jump into isn't going to give them credit for all that past service and they suffer more and that is a real problem, too.

But if you were to tell employers that you have got to fund the COLAs just like this Federal Government is, or if you tell them that you have to be able to figure in on what you have to contribute also to make sure that you will be able to guarantee the fellow who has a frozen accrual, there aren't going to be people that go into it.

That is the problem that I think all of us see here, and maybe we almost feel at this point there isn't any way to get there from here. I am sure there is.

Mr. **Roybal**. Thank you, Mr. Fawell. The time of the gentleman is expired.

I would like to compliment the panel for their very excellent testimony. I would like to add at this time some statistics that may be of interest, not only to the panel, but to the members of this committee, that United Airlines stock—on May 15, could have been bought for $46. On the day of the announcement of their termination plan, it was $58 and a tenth, a jump by more than $12. Today, that stock is $56, which is $10 more than it was on May 15, just a month ago. Anyone who made that investment was a pretty shrewd investor.

May I thank the members of the panel. You can be sure that this committee will take your testimony under consideration and will do everything we possibly can to be of assistance in bringing some resolve to the problem before us.

Thank you very much.

The next panel is made up of Don Grubbs, Michael Gordon, and David Marshall. Will you please take your respective seats and proceed in any manner that you desire.

First of all, I would like to have Mr. Grubbs start. He is a consultant and also an actuary.

Mr. Grubbs, will you open the discussion at this time.

PANEL TWO: CONSISTING OF DON GRUBBS, CONSULTING ACTUARY, BUCK CONSULTANTS INC., WASHINGTON, DC; DAVID MARSHALL, VICE PRESIDENT OF EMPLOYEE BENEFITS FOR NABISCO BRANDS, INC., EAST HANOVER, NJ, AND A MEMBER OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS BOARD OF DIRECTORS; AND MICHAEL GORDON, PENSION ATTORNEY, WASHINGTON, DC, AND FORMER MINORITY COUNSEL TO THE SENATE LABOR COMMITTEE

STATEMENT OF DON GRUBBS

Mr. GRUBBS. Thank you, Mr. Chairman.

I am not going to read my written testimony. I will try to summarize it. The problems that we are facing today are, indeed, serious problems. They are difficult ones to solve.

I look at those problems both as one who is concerned for the needs of the employees and also one who has consulted for corporations with respect to plan terminations and see their needs and problems as well. I speak as an individual and do not present the viewpoints either of my firm or any of the corporations for which I consult.

My written testimony on the first page outlines the topics that I describe. I talk about why defined benefit plans are valuable to employees—and they are very valuable to employees—as Bert Seidman has briefly summarized. I discuss why terminations of defined benefit plans with reversions have increased so much the last 4 years and list eight separate causes for that increase.

I describe the effect on employees and it has generally been a bad effect on employees, as well as a bad effect upon PBGC by eroding their premium base, which in the long run is bad for all defined benefit plans because they have to pay the premiums.

I describe how the present laws effect plan termination. If an employer needs the excess assets for whatever reason, present law is clear. If a plan is terminated, a reversion of assets is allowed under present law under both the Internal Revenue Code and ERISA. If you don't have a plan termination, you can't get any assets out of the plan. Thus, the law forces employers who want the assets back to terminate the plan and that is the wrong kind of incentive.

I discuss the reestablishment terminations and spinoff terminations which Senator Metzenbaum has described, those in which you do in two steps what you couldn't do in one, in effect withdrawing assets from an ongoing plan.

Some say that this is a sham and they say that the two-step should be prohibited, but I say the answer is not simply to abolish the reestablishment terminations and spinoff terminations. If you tell people you can't get your assets back through that vehicle, then you force them to have a real termination of the plan, which is even worse. So that is not an answer.

On the other hand, the administration guidelines have serious problems. First, they have no basis in law and, therefore, are unlikely to be upheld in court in my opinion. Second, if the policy is a good one, if the withdrawal of assets should be allowed from an ongoing plan, which is what the two-step termination is, why force people to go through a sham to do it? Why not let them do it directly?

The third thing wrong with the administration policy is that it hasn't worked. In spite of this policy, we have had a continuing flood of terminations. It doesn't address at all the far larger problem of the defined benefit plan being replaced by defined contribution plans.

I discuss the legislative alternatives, a combination of carrots and sticks, an encouragement for employers to continue their plans on the one hand, or some kind of penalty on discontinuance. It is trying to find the right combination which is the tough problem you face.

In connection with this, we must keep in mind that if the penalties are too severe, it will discourage employers from establishing plans and will discourage them from soundly funding the plans above the minimum required contributions if those assets are forever locked in.

After examining these on page 14 of my testimony, I suggest the solution. The solution to this problem is to amend ERISA and the Internal Revenue Code to allow employers to make withdrawals of the excess assets from ongoing plans, thus removing the incentive to terminate the plan. It should be noted that this withdrawal will put the plan in a funding position that is consistent with the criteria under present law of the alternative minimum funding standard.

In order to protect the security of accrued benefits, the amount to be withdrawn needs to be limited in three ways: First, the assets withdrawn must be limited to assets in excess of the value of accrued benefits so the accrued benefits will remain funded; second, to whatever extent that the accrued benefits are not guaranteed by an insurance company, adverse experience with either the liabilities, such as participants living longer than expected or with the assets, for example, a market value decline or income less than expected, could cause the accrued benefits to be underfunded. To solve this problem, it is suggested that the assets required to be left with the plan include any annuity or insurance contracts that guarantee the payment of accrued benefits plus 120 percent of the value of any accrued benefits not insured with such contracts. This would leave a cushion of protection for adverse experience.

Third, since a withdrawal of assets weakens the funding of the plan on an ongoing basis, the amount withdrawn should be treated as an actuarial loss, the same as if the assets had declined in value by this amount. All such actuarial losses should be required to be amortized over 15 years, the usual period for funding actuarial losses. Thus, the amount withdrawn to meet immediate needs would be repaid by the employer over a reasonable period.

This approach allows employers to obtain the assets when needed while continuing the plan. This carrot to continue the plan can be combined with the stick of a 10 percent excise tax upon a real plan termination, 10 percent of any reversion or of the balance of a prior withdrawal that hadn't been amortized.

In conclusion, the fundamental problem is that employees are losing pensions because current law gives employers an incentive to terminate defined benefit plans in order to obtain the plan's excess assets. The solution is to allow employers to withdraw excess assets without terminating the plan, while maintaining controls to protect the funding of all the accrued benefits.

This approach can be combined with the disincentives to termination of an excise tax if the plan is actually terminated.

Thank you.

[The prepared statement of Mr. Grubbs follows:]

TERMINATION OF PENSION PLANS WITH ASSET REVERSION BY DONALD S. GRUBBS, JR., F.S.A., CONSULTING ACTUARY, BUCK CONSULTANTS, INC.

This discusses the problem of termination of defined benefit pension plans with a reversion of assets to the employer and proposes a solution. The viewpoints presented are solely those of the author.

The subheadings summarize the topics presented:

1. Why Defined Benefit Plans Are Valuable to Employees;
2. Why Terminations of Defined Benefit Plans with Reversion of Assets Have Increased;
3. The Effect of Plan Terminations on Employees;
4. How Present Laws Affect Plan Terminations;
5. Reestablishment Termination and Spinoff Termination;
6. Legislative Alternatives;
7. The Solution: Allow Certain Withdrawals under Ongoing Plans; and
8. Conclusion.

In a nutshell, termination of defined benefit pension plans is generally bad for employees. Many thousands of employees have lost the protection of pension plans, and this erosion will continue unless the law is changed. Plan terminations with reversions have increased because some employers need the money and realize that under present law termination of the pension plan is the only way to get it.

The present law provides the wrong incentives. The answer is to amend the law to allow employers to withdraw excess assets from the plan but still continue the plan, with controls to assure that all accrued benefits will continue to be fully funded.

1. *Why Defined Benefit Plans Are Valuable to Employees.*—The principal purpose of private pension plans is to provide a retirement income which, together with Social Security and personal savings, will provide retired workers with an adequate income in their retirement years. Adequacy can be thought of in terms of enabling the retired worker to maintain a standard of living similar to that which he enjoyed before retirement.

Defined benefit pension plans are well suited to this task. Defined benefit plans generally provide an income that continues as long as the participant lives. They also provide joint and survivor benefits that assure continuance of the pension for the lifetime of the retired worker's spouse. In contrast, under defined contribution plans benefits are usually paid as a lump sum which may be spent or lost through poor investment long before the retiree's death, leaving the retiree in poverty in his old age.

Defined benefit plans can have a benefit formula designed to produce a pension which, together with social security, provides an adequate level of income. A plan might provide, for example, that an employee retiring at age 65 after 30 years of service will receive a pension equal to 70% of the employee's 3-year-final-average pay reduced by 50% of his primary Social Security benefit. For long service employees, the combination of such a defined benefit pension plan and Social Security do a pretty good job of providing an adequate income for employees at all levels of pay. Defined benefit plans usually provide benefits for all years of service, including years before the plan was established. In contrast under a defined contribution plan, even if a life annuity is provided, the amount of income that can be provided depends on the plan's investment experience and cannot be reasonably predicted. In addition a defined contribution plan generally provides no benefits related to past service and generally does not do a good job of meeting retirement income needs of employees who are older when the plan is established.

This is not intended to state that all defined benefit plans are ideal or that such plans have no problems. But it is clear that defined benefit plans play a major role in meeting retirement income needs of millions of American workers, and that no other type of private retirement program can fill this need as well.

2. *Why Terminations of Defined Benefit Plans with Reversion of Assets Have Increased.*—In the last four years there has been a large increase in the termination

of defined benefit pension plans with a reversion of excess assets to the employer. A number of factors have tended to cause this increase, including the following:

1. Most plans have funding policies designed to fund the projected benefits payable at retirement age, based upon salary rates projected to be payable at that time. When a plan is terminated, the benefits are limited to those already accured based upon past salaries. The liabilities upon plan termination, limited to the benefits accrued to date, are usually substantially less than the liabilities that were being funded to secure the projected benefits that would have been payable if the plan had continued. Thus the existence of excess assets upon plan termination is frequently a very natural result, resulting from the decrease in liabilities caused by the event of termination. Thus plan assets that were not excess in relation to the needs of an ongoing plan become excess assets if the plan is terminated.

2. The funding of an ongoing pension plan is a long term project. The actuary selects assumptions, including interest assumptions, which cover periods of 40 or more years in the future. Very appropriately the actuary uses conservative assumptions for funding over such long term periods of the future. In the last few years some plans have experienced investment returns substantially larger than assumed. For some plans this has substantially increased the excess assets available upon plan termination.

3. Interest rates have risen dramatically in recent years. Insurance companies have used these higher interest rates to develop annuity purchase rates to guarantee the benefits under pension plans at lower cost than the liabilities determined by the plan's actuary. By purchasing such annuities to guarantee all benefits earned to date, a pension plan can often substantially decrease the amount of its liabilities and thus increase the amount of excess assets.

4. Many businesses have experienced heavy financial losses in recent years. Such businesses find themselves in need of substantial assets to satisfy creditors, prevent bankruptcy, or finance capital investments needed to restore profitability. Other employers desire capital to finance expansion or acquisitions. Such needs have come at a time when the cost of borrowing money is very high and the company's credit position may make borrowing difficult. Terminating the pension plan to obtain the needed assets may be an attractive solution.

5. The existence of excess assets available upon termination of a company's pension plan may make the company an attractive target for takeover by others. This may not only lead to termination by an acquirer; it may also cause a company to terminate its plan in order to remove the temptation to potential acquirers.

6. Beginning in 1980, Statement 36 of the Financial Accounting Standards Board forced employers to begin including in their financial statements the value of plan assets and the value of accured liabilities, making the excess assets visible for the first time. This has caused employers to focus on the excess, and to consider recovering it to meet their needs.

7. The actions of a few large employers have been highly publicized causing other employers to consider the idea.

8. Plan termination is the only way to recover excess assets.

3. *Effect of Plan Terminations on Employees.*—Regardless of the cause of plan terminations, the result is usually the loss of an important source of retirement income security for employees.

One reason for this loss is that sometimes, rather than having their accrued benefits guaranteed by purchase of annuities from an insurance company, employees are provided a lump sum distribution, which can be spent currently rather than preserved to provide retirement income.

The second part of this loss is the loss of benefits that would have accrued in the future if the plan had continued. In many cases the terminated defined benefit plan is replaced with a defined contribution plan which at least has the potential of providing an adequate retirement income for younger members if it is applied to provide a life annuity. But for older workers a defined contribution plan is almost never adequate to replace the income lost under the discontinued plan. And for workers of all ages, defined contribution plans usually allow distribution in the form of a lump sum that in many cases will not be preserved to provide retirement income.

In addition, the termination of overfunded plans reduces the premiums received by the Pension Benefit Guaranty Corporation (PBGC), tending to undermine the system of plan termination insurance. This chipping away at PBGC's contribution base will force larger increases in the premium rate for all remaining defined benefit pension plans, further discouraging employers from establishing and continuing such plans.

4. *How Present Laws Affect Plan Terminations.*—When a defined benefit plan is terminated with plan assets exceeding the value of accrued benefits, present law generally permits a reversion to the employer of this excess. (ERISA § 4044(d); Treasury Reg. § 1.401-2). If a defined benefit plan is not terminated, the employer is generally forbidden from withdrawing any assets from the plan, regardless of how much excess assets the plan may have. (ERISA § 403(c)(1); Internal Revenue Code § 401(a)(2)).

Thus an employer that has a plan with excess assets and needs the money for business purposes is forced to terminate the plan to obtain the excess assets. The fundamental problem is that present law gives an employer a very strong incentive to terminate its defined benefit plan in order to obtain the needed excess assets. This is the problem which must be solved.

5. *Reestablishment Termination and Spinoff Termination.*—Some employers, desiring to continue their defined benefit plan but also desiring to withdraw assets, sought ways to bypass the law against withdrawing plan assets without a plan termination. They adopted the "reestablishment termination" or the "spinoff termination".

Under a "spinoff termination" the plan is split into two plans, one for active employees and one for retirees, with all of the excess assets placed in the retirees' plan; the retirees' plan is then immediately terminated with a reversion of assets to the employer, while the active employees' plan is continued. Under a "reestablishment termination" the plan is terminated with a reversion of the excess assets to the employer, and immediately another defined benefit plan is established, identical or similar to the plan just terminated. In these cases the employer accomplishes in two steps what is forbidden in one. Some ask, "Has there really been a plan termination?"

A 1963 IRS regulation states: "Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. For example, a plan is terminated when, in connection with the winding up of the employer's trade or business, the employer begins to discharge his employees. However, a plan is not terminated, for example, merely because an employer consolidates or replaces that plan with a comparable plan."

Some within IRS have argued that the step transaction doctrine should be applied to spinoff terminations and reestablishment terminations. According to the step transaction doctrine, if actions taken in two transactions have substantially the same result as could have been obtained in a single transaction which would have been disallowed, then the two transactions shall be treated as a single transaction for tax purposes. They argue that the spinoff termination and the reestablishment termination are merely shams in which the employer dances the two step to accomplish what is essentially a withdrawal of assets from an ongoing plan—a reversion that would be clearly prohibited if done in one step.

But those inside and outside the IRS have recognized that a serious problem is presented if the step transaction doctrine is applied. If an employer needs the excess assets and can obtain those assets by a complete plan termination, but is blocked from getting them under a two-step termination, the employer will have a very strong incentive to completely terminate the plan. Defined benefit plans are generally good for employees, and their continuation is to be encouraged. Providing employers the incentive to completely terminate defined benefit plans would not be good for either employees or the PBGC. This indicates that the step-transaction doctrine should not be applied, regardless of its theoretical justification.

Therefore the Administration published "Implementation Guidelines", stating that two-step terminations would be treated as true terminations and asset reversions would be allowed, if certain conditions are satisfied. Some of the conditions apparently lack any statutory basis, and are currently being challenged. The Guidelines do not affect the more common occurrence of terminating a defined benefit plan with no continuing defined benefit plan.

6. *Legislative Alternatives.*—Many feel that present law is inadequate to deal with these problems. A wide variety of legislative solutions have been suggested.

Some have argued against allowing any reversion of assets whatsoever on any plan termination, arguing that all plan assets should in all cases be used to benefit participants and beneficiaries. Opponents argue that such a policy would be unfair to employers, forcing them to forego the benefits of favorable experience even though they are required to make up any losses on unfavorable experience. In addition, a no-reversion policy would discourage employers from establishing defined benefit plans and would encourage employers to fund plans on a marginal basis in order to preclude the existence of excess assets to the extent possible, clearly very negative effects for participants and for PBGC.

Others have advocated a modification of this proposal, prohibiting all reversions except those necessitated by certain circumstances, such as the bankruptcy of the employer, the termination of employment of all covered employees, or perhaps business hardship. This would forbid discontinuing the plan unless the continuation is not feasible. While the termination of defined benefit plans is generally against the interest of participants and beneficiaries, this proposal would have the same adverse consequences as the prior proposal in discouraging employers from establishing plans and from soundly funding them.

A third approach would limit the reversion to the amount of excess rising from particular sources, such as the amount resulting from excess interest income. Such a proposal has serious technical problems which actuaries can describe in detail. In addition, like any proposals to substantially limit the reversion of excess assets, it may discourage employers from establishing and soundly funding plans.

Another proposal would allocate the excess assets upon termination of a noncontributory defined benefit plan between the employees and employer. Part of the excess assets could be allocated to assure post-retirement increases related to the accrued benefits in order to ameliorate the problems of inflation. The rationale behind this proposal is several fold. First, it is clear that accrued benefits are deteriorated by the effects of inflation and that employees need help with this problem. Second, this approach is a compromise between those who think that all of the excess assets should go to participants and those who think all should go to the employer. Third, the existence of the excess assets results in large part from high interest rates, which in turn are associated with the high inflation that deteriorates pensions. Thus it is rational that the excess interest earned be used to offset the deterioration in pensions from the related inflation. However, this proposal would tend to discourage employers from establishing plans and soundly funding them.

Some propose an excise tax upon any reversions which occur. The purpose of this is twofold. First, it would generally discourage terminations of plans for the purpose of obtaining reversions of assets. Second, it addresses the alleged tax inequity. It has been pointed out that it is possible for an employer to put money into a pension plan in a year when it is in a high tax bracket and to withdraw it in a later year when it is in a lower tax bracket or when it has no tax liability at all. But the amount received is included in taxable income. This usually results in current taxation. Even if the employer has a tax loss carry over avoiding current taxation, the distribution reduces the amount carried forward and thus generally increases future taxes. Nevertheless tax deferral is itself a kind of tax benefit. But this is the same tax treatment which anyone receives if he purchases real property for business purposes, claims a tax deduction for depreciation for several years, and then disposes of the property at a gain, except that this latter event generally enjoys capital gains treatment as well.

It is true that corporations and individuals often time their actions between tax years in such a way as to minimize their taxes. For example, an individual or business may time a tax deduction to occur in a year when the taxpayer is in a higher tax bracket. Under any tax law, law abiding citizens will quite properly conduct their affairs in a lawful manner that tends to minimize taxes. No tax law is perfectly equitable, and it can be argued that such tax planning increases the inequities. But few expect to abolish all inequities. The tax inequity related to pension plan reversions is a very minor portion of the questions of tax equity related to the timing of events. To my knowledge, tax considerations have not been the primary reason for any plan termination. Like the proposals to substantially restrict reversions, the excise tax proposal would have the effect of discouraging defined benefit pension plans and of discouraging sound funding. And for employers that greatly desire the reversion, a 10% excise tax by itself may not be enough deterrent. The object, after all, is not to collect taxes but to encourage the continuation of plans.

Congress could choose to do nothing and to continue the present law. In favor of this proposal is the fact that it avoids all of the disadvantages cited for the alternative proposals discussed. It allows employers to recover the excess assets which they need, while allowing them to continue defined benefit plans by dancing the two step.

But why should the law force employers to dance the two step? If the result is right, should it not be allowed in one step, permitting withdrawal from ongoing plans without the farce of pretending there has been a termination? The second problem of current law is that the withdrawal of "excess" assets, which are "excess" only when viewed from the perspective of plan termination but are really needed for funding an ongoing plan, does undermine the minimum funding requirements and tends to undermine sound funding. Third, under present administrative interpretations the law forces plan sponsors to purchase annuities under ongoing plans, an approach which may increase the cost of funding the plan in the long run. Fourth, this approach abolishes any cushion of protection for PBGC. Fifth, the approach taken by the regulators under present law may not withstand challenge in the courts. Finally, when the decision to terminate the plan has been made, most employers have in fact switched to a defined contribution plan, destroying the assurance of a pension income. Thousands of workers have lost their pensions, and the present law results in the losses continuing.

Another proposed solution is to allow loans of excess assets from ongoing plans, to be paid back with amortization over some stipulated period. Like present law, this has the advantage of allowing employers to get the assets which they need for current purposes and encourages them to continue their defined benefit plans. Unlike present law, the repayment provision would gradually restore the sound funding position of the plan. But this approach involves greater tax inequities than present law and would be subject to potential tax abuse. Under current law the reversion is taxable income to the employer, while under the loan approach the amount withdrawn would not be taxable income. Under the loan approach an employer might put money into the fund on a very strong funding basis, contributing the maximum deductible limit on the basis of very conservative methods and assumptions in order to maximize the tax deduction; it could then withdraw the money by way of a loan with no current taxable income, even if the corporation is in the highest tax bracket currently.

7. *The Solution: Allow Certain Withdrawals Under Ongoing Plans.*—The solution to this problem is to amend ERISA and the Internal Revenue Code to allow employers to make withdrawals of the excess assets from ongoing plans, thus removing the incentive to terminate the plan.

It should be noted that this withdrawal will put the plan in a funding position that is consistent with the criteria under present law of the alternative minimum funding standard (ERISA § 305, Internal Revenue Code § 412(g)).

In order to protect the security of accrued benefits, the amount to be withdrawn needs to be limited in three ways:

First, the assets withdrawn must be limited to assets in excess of the value of all accrued benefits, so that all accrued benefits will remain funded.

Second, to whatever extent that the accrued benefits are not guaranteed by an insurance company, adverse experience with either the liabilities (e.g. participants living longer than expected) or the assets (e.g. market value decline or income less than expected) could cause the accrued benefits to be underfunded. To solve this problem it is suggested that the assets required to be left with the plan include any annuity or insurance contracts which guarantee the payment of accrued benefits plus 120% of the value of any accrued benefits not insured with such contracts.

Third, since a withdrawal of assets weakens the funding of the plan on an ongoing basis, the amount withdrawn should be treated as an actuarial loss, the same as if the assets had declined in value by this amount. All such actuarial losses should be required to be amortized over 15 years, the usual period for funding actuarial losses. Thus the amount withdrawn to meet immediate needs would be repaid by the employer over a reasonable period.

This approach allows employers to obtain the assets when needed, while continuing the plan. This carrot could be combined with the stick of a 10% excise tax upon plan termination of any reversion or of the balance of a prior withdrawal not yet amortized.

8. *Conclusion.*—The fundamental problem is that employees are losing pensions. The cause is that current law gives employers an incentive to terminate defined benefit plans in order to obtain the plan's excess assets. The solution is to allow employers to withdraw the excess assets without terminating the plan, while maintaining controls to protect the funding of all accrued benefits. This approach can be combined with the disincentives to termination of an excise tax.

Mr. ROYBAL. Thank you, Mr. Grubbs.

Your written testimony will be included in the record prior to your verbal statement.

The Chair now recognizes Mr. David Marshall.

STATEMENT OF DAVID MARSHALL

Mr. MARSHALL. Thank you, Mr. Chairman, and members of the subcommittee.

My name is David Marshall and I am vice president of employee benefits for the Nabisco Brands Co.

I am here today representing the Association of Private Pension & Welfare Plans, the APPWP. I would like to briefly summarize remarks from my written testimony that has already been submitted.

Mr. ROYBAL. Your written testimony, then, will appear in the record.

Mr. MARSHALL. Thank you.

The APPWP represents over 475 organizations across the United States, including hundreds of plan sponsors both large and small. Additionally, our membership includes leading organizations that support the Nation's private employer-sponsored benefit system. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by American industry.

We appreciate this opportunity to provide our perspective of reversion on excess assets to the employer sponsors of defined benefit plans. In our view, a carefully considered, appropriately balanced national policy in this area is critical to the continued viability and growth of defined benefit plans.

The cornerstone of the pension programs maintained by America employers is and should continue to be defined benefit plans. Few would argue with the proposition that defined benefit plans provide the most secure and valuable retirement benefit to our Nation's workers.

Under such plans, the employees' benefit is fixed and is generally related both to compensation and length of service. There is no investment risk to the participant and basic benefits are guaranteed by the Pension Benefit Guaranty Corporation.

Nor can there be significant argument with the fact that today defined benefit plans are among the most expensive type of benefit plans that an employer can maintain. Under defined benefit plans, the employer assumes all the investment risks with respect to plan assets. If the market value of assets decreases, the employer's annual funding obligation is concomitantly increased. Administrative costs and regulatory requirements, as well as the PBGC premium, add to the overall burden of maintaining a defined benefit plan.

Unlike profit sharing or stock bonus plans, the employer sponsor of a defined benefit plan may not retain unfetter discretion with respect to the obligation to make contributions. Even if the employer can meet the requirements for a waiver of the minimum funding standards, his obligation to make the actuarily determined contribution is only delayed, not eliminated.

In addition, coverage under ERISA title IV insurance programs is mandated for virtually all defined benefit plans. Thus, it is clear why most employees favor coverage under a defined benefit plan. It is also apparent that the risks and financial responsibilities of the plan's sponsor, as well as other factors such as inflation and high interest rates, have created a disincentive for employers to establish defined benefit plans.

The public controversy regarding reversion of excess assets from terminating defined benefit plans has been a focus of the benefit community's attention since early 1982. Although the language of ERISA and the Internal Revenue Code quite expressly permit reversion, there are those who would argue that this policy should be reconsidered by the Congress. We urge you to approach this question armed not only with a clear understanding of the importance of defined benefit plans to American workers, but also of the burdens already placed on employers who have chosen to maintain these plans.

The strength of our pension system is that it is voluntary. No particular type of plan or level of benefits is mandated, and indeed, no employer is required to establish or to continue to maintain a retirement plan at all.

The trend, as noted in other testimony, toward defined contribution plans has escalated significantly in the last 10 years and shows no sign of slowing. Defined contribution plans, as a means of controlling corporate benefit costs, are very attractive because contributions are generally based on a percentage of payroll and annual costs are always known. Administrative costs are also much lower than in defined benefit plans since complicated actuarial valuations are not necessary and complex annuity rules may be avoided.

The defined contribution plan may also alleviate protracted recordkeeping once an employee has terminated service. A defined contribution plan avoids the defined benefit plan's inherent commitments to adequate retirement income because the risk of plan investments is shifted to the employee.

In our view, any ill-considered increase in the financial and administrative burdens associated with defined benefit plans may well signal their demise. Thus, in summary, the APPWP views with alarm the legislative proposals which would change the current incentives that exist for defined benefit plans. As I have already noted, participants in defined benefit plans have an advantage that is unparalled in other retirement plans, a fixed promised benefit.

Of course, there is no promise that the plan will always continue, nor could there be in our system. Certain legislative proposals would alter the current system by requiring increased benefits on termination for participants whose employers have inadvertently overfunded their plans.

Under the proposed changes, an employer would be at risk not only for the estimated funding needs of the plan to support the promised benefit, but also for a higher benefit based on the assets available at termination.

The logical response of plan sponsors would be to insist on using funding assumptions that are far less conservative so as to avoid the inadvertent ballooning of benefits upon plan termination.

If the plan were underfunded on termination, the employer could always agree to make the plan sufficient at that time or, if unable to do so, would shift the liability to the insurance system. No one is served by such results. Moreover, if Congress believes that cost-of-living increases should be mandated under ERISA for retirees, that proposal should be made directly and addressed on its merits, rather than affectuating such increases only for participants in terminated plans under the guise of restricting reversions.

By the same token, any suggested excise tax on the reversion of funds to an employer at plan termination is a disincentive to responsible funding. Such a tax is inconsistent with our voluntary system and unnecessarily duplicates the already existing corporate tax imposed on reversions. The proposals now being discussed would add new bureaucratic layers to the termination process, increasing its expense not only for the plan sponsor, but for the Federal Government as well.

The APPWP would strongly oppose such legislation because, in our view, it works to the ultimate detriment of all plan participants.

Thank you.

[The prepared statement of Mr. Marshall follows:]

TESTIMONY OF THE ASSOCIATION OF PRIVATE PENSION & WELFARE PLANS

Mr. Chairman, Members of the Subcommittee, Congressman Roybal, I am David G. Marshall, of Nabisco Brands Incorporated, and I am here today representing the Association to Private Pension and Welfare Plans ["APPWP"]. The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of this country's private benefit system. The APPWP represents over 475 organizations across the United States including hundreds of plan sponsors, both large and small. Additionally, our membership includes the leading organizations that support the nation's private employer-sponsored benefits systems: investment firms, banks, insurance companies, accounting firms and actuarial consulting firms. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by American industry.

I appreciate this opportunity to provide our perspective on reversion of excess assets to the employer sponsors of defined benefit plans. In our view, a carefully considered and appropriately balanced national policy in this area is critical to the continued viability and growth of defined benefit plans. We would point out that the APPWP represents hundreds of employers who maintain pension and welfare programs for their employees. The health insurance progams of U.S. businesses cover over 90% of America's full-time workers. The pension programs of U.S. employers, for people in their 40's today, will provide pensions to 82% of married couples and 58% of unmarried individuals. These programs are of great importance to all workers. The cornerstone of the pension programs maintained by America's employers is and should continue to be defined plans. Few would argue with the proposition that defined benefit plans provide the most secure and valuable retirement benefit to our nation's workers. Under such plans, the employee's benefit is fixed, and is generally related both to compensation and length of service. There is no investment risk to the participant, and basic benefits are guaranteeed by the Pension Benefit Guaranty Corporation. Nor can there be significant argument with the fact that today, defined benefit plans are among the most expensive type of benefit plan that an employer can maintain. Under defined benefit plans, the employer assumes all the investment risk with respect to the plan's assets. If the maket value of the assets decreases, the employer's annual funding obligation is concomitantly increased; administrative costs and regulatory requirements, as well as the PBGC premium add to the overall burden of maintaining a defined benefit plan.

Due to recent economic conditions, the cost of maintaining a defined benefit plan to a given employee population could fluctuate anywhere from 6 to 20 percent of payroll. The large variation in defined benefit plan costs is due primarily to investment risk. Under such a plan, the employer underwrites the risk of promising a particular benefit level, and assumes the risk of rising costs related to unknown investment fluctuations. Additional costs may be incurred, if, for example, the employer gives credit for service before the plan was adopted, or if the employee population is significantly older than an average employee group. This range of costs is considerably wider than estimates of ten to fifteen years ago.

Unlike profit sharing or stock bonus plans, the employer sponsor of a defined benefit plan may not retain unfettered discretion with respect to the obligation to make contributions, or the level of those contributions. Even if an employer can meet the requirements for a waiver of the minimum funding standards, his obligation to make the actuarially determined contribution is only delayed, not eliminated. In addition, coverage under the ERISA Title IV insurance program is mandated for virtually all defined benefit plans, and current plan sponsors face nearly a three-fold increase in the premium charged for such coverage if the PBGC's requested rise in the premium to $7.50 per participant per year is enacted by Congress. Thus, while it is clear why employees favor coverage under a defined benefit plan, it is also apparent that the risks and financial responsibilities of the high interest rates, have created a disincentive for employers to establish defined benefit plans.

The public controversy regarding reversion of excess assets from terminating defined benefit plans has been a focus of the benefit community's attention since early 1982. Although the language of ERSIA and the Internal Revenue Code quite expressly permit reversion, there are those who argue that this policy should be reconsidered by the Congress. We urge you to approach this question armed not only with a clear understanding of the importance of defined benefit plans to American workers, but also of the burdens already placed on employers who have chosen to maintain these plans. The strength of our pension system is that it is voluntary; no particular type of plan or level of benefits is mandated, and indeed no employer is required to establish or continue to maintain a retirement plan at all.

The trend toward defined contribution plans has escalated significantly in the last 10 years and shows no sign of slowing. Indeed, 1984 was the first year in which the number of defined benefit plan participants covered under the Title IV insurance system declined. Defined contribution plans, as a means of controlling corporate benefit costs, are very attactive. Because contributions are generally based on a percentage of payroll, annual costs are always known. Administrative costs are also much lower than in defined benefit plans, since complicated acturial valuations are not necessary and complex annuity rules may be avoided. The defined contribution plan may also alleviate protracted recordkeeping—once an employee is cashed out, there is no obligation to track this employee in the future. A defined contribution plan avoids the defined benefit plan's inherent commitment to adequate retirement income because the risk of plan investments is shifted to the employee. There is also the continuing debate over whether pension liabilities should be reflected in a company's balance sheet, and how they should be reflected. If this were required, it would wreak havoc on the credit status of a substantial number of companies and lead to new impediments against the continuance or adoption of defined benefit plans.

In our view, any ill-considered increase in the financial and administrative burdens associated with defined benefit plans may well signal their demise.

The current legal framework that surrounds defined benefit plans represents a fragile balance of equities and risks. An employer is not free to contribute amounts of any magnitude to a defined benefit plan; rather, the Code's minimum funding standards set forth minimum and maximum limitations on deductible contributions to these plans. These limits depend on actuarial estimates of long term interest rates, mortality of plan participants, retirement dates and the like. Generally, those estimates have been quite apt, when considered, as they must be, over a period of twenty to thirty years. In the late 1970's the hue and cry was raised with respect to plans that were severely underfunded and threatening the retirement security of millions of Americans, as well as the solvency of the Title IV insurance system. Five years later, lowered inflation and market improvements have given rise to criticism of overfunded plans and charges that employee's rights are abused by permissive termination of these same plans. We seem to lose historical perspective in a rush to judgment every few years. There was no significant drop in the number of defined benefit plans due to precipitious termination in the 1970's; so the majority of plans will continue to be maintained through this overfunded period. If there has been any incentive to accelerate plan termination, it has come from this debate on reversions in the Congress, and a perception on the part of employers that legislation will be enacted to bar terminations, or to penalize employers for their historic responsible funding of plans by denying them the assets which, upon plan termination, prove unnecessary to fund the benefits they have promised.

Congress has on at least three occasions considered whether reversions should be permitted. In all three instances Congress has expressly affirmed the employer's right to surplus assets upon the termination of the plan and the complete satisfaction of all plan liabilities. The rule govering reversions was initially adopted by Congress because it recognized that it is only fair to permit the employer to recover the amount in excess of that needed to provide the employees' earned benefits under the plan. We strongly believe that the policy grounds for permitting a reversion remains as sound today as when Congress adopted and reaffirmed the position permitting a reversion of an employer.

Thus, the APPWP views with alarm the legislative proposals which would change the current incentives that exist for defined benefit plans. As I've already noted, participants in defined benefit plans have an advantage that is unparalleled in all other retirements plans: a fixed, promised benefit. Of course, there is no promise that the plan will always be in existence; nor could there be in our system. Assets are accumulated using the best estimates available to pay the promised level of benefits at retirement. There is no evidence that the "estimating" process is skewed to overfund or underfund; to the contrary, an enrolled actuary for the plan must certify that the actuarial assumptions, used are reasonable in the aggregate.

Certain legislative proposals would alter the current system by requiring increased benefits on termination for participants whose employers have inadvertently overfunded their plans. Under these proposed changes, an employer would be at risk not only for the estimated funding needs of the plan to support the promised benefit, but also for higher benefit based on the assets available at termination. The logical response of plan sponsors would be to insist that funding assumptions be far less conservative, so as to avoid the inadvertent ballooning of benefits on termination. If the plan were underfunded on termination, the employer could always agree to make the plan sufficient at that time, or, if unable to do so, shift the liability to the insurance system. No one is served by such a result.

Moreover, if the Congress believes that cost of living increases should be mandated under ERISA for retirees, that proposal should be made directly and addressed on its merits, rather than effectuating such increases only for participants in terminated plans under the guise of restricting reversions. Similarly, any suggested excise tax on the reversion of funds to an employer at plan termination is a disincentive to responsible funding. Such a tax is inconsistent with our voluntary system, and unnecessarily duplicates the already existing corporate tax imposed on reversions. The proposals now being discussed would add new bureaucratic layers to the termination process, increasing its expense not only for the plan sponsor but for the federal government as well. The APPWP would strongly oppose such legislation, because in our view, it works to the ultimate detriment of all plan participants.

In May of 1984, just a week ago, the three agencies charged with enforcement of ERISA developed detailed guidelines on reversion of excess assets after almost two years of study and debate. In addition, the Retirement Equity Act's restrictions on the interest rate used to cash out participants has eliminated a recognized abuse on plan termination. There is no reason to believe that these guidelines and the recent changes in the law are ineffectual in protecting employees; nor should they be impetuously overridden by ill-thought through legislation before their effects can be evaluated. At risk here is the future of defined benefit plans; over-regulation and undue restrictions will not inure to anyone's benefit. To the extent that employers decide that defined benefit plans are not worth their cost and burden, all employees will suffer, as they become the risk takers with respect to their retirement security. We believe that this issue should be addressed with full recognition of the dangers of radically departing from the current legal framework which has enouraged the growth of defined benefit plans.

Mr. ROYBAL. Thank you, Mr. Marshall.

Mr. Gordon.

STATEMENT OF MICHAEL GORDON

Mr. GORDON. Thank you, Mr. Chairman.

Mr. Chairman, I have attached to my rather lengthy prepared statement, which I understand will be included in the record——

Mr. ROYBAL. Without objection, your entire written statement will be included in the record. You may summarize.

Mr. GORDON. Thank you.

I would just like to note that attached to it is a paper I delivered to the Wharton School of Finance on the legislative history of ERISA's asset reversion provision and I ask unanimous consent that it be included as well.

Mr. ROYBAL. Without objection, it will be included.

Mr. GORDON. Thank you, Mr. Chairman.

My name is Michael Gordon. I am an attorney practicing in Washington, DC, specializing in ERISA. I participated for over 10 years in the legislative process that culminated in the enactment of

ERISA. During the period 1970–1975, I served under an appointment by Senator Javits as minority counsel for pensions to the U.S. Senate Committee on Labor and Public Welfare, and prior to that time, I served as the Department of Labor's counsel to President Kennedy's Cabinet Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs.

I should add that I have also had some fairly recent experience with some overfunded plan terminations so I have had some concrete experience with the subject.

I would like to emphasize that this is probably one of the most serious abuses in the private pension field that I have seen going back over a period now in excess of 20 years. In fact, in some respects, compared to the kinds of abuses that occurred prior to ERISA and which triggered off ERISA, it may be worse.

Mention has been made, for example, of what percentage of plans, what percentage of assets are affected. Let me point out that the underfunded plan terminations that gave rise to title IV of ERISA and PBGC constituted less than one-half of 1 percent of the total number of plans and funds in existence at that point.

The number of fiduciary violations, breaches of trust that were taking place, some in some plans on a rather large scale, nevertheless, when viewed from an overall statistical viewpoint, were very, very small. Nonetheless, Congress felt compelled to act because the kinds of abuses that were displayed cast a tremendous shadow over the integrity of the entire private pension system. I believe that that is the case today. I think that Congress has to act promptly and not wait too much longer to deal with this problem.

The reason is that the same benighted corporate mentality that gave us the $7,400 coffeemaker and the $659 ashtray is also giving us the premature plan termination designed for no other reason than to enable plan sponsors to make off with funds that were accumulated for the benefit of their employees. Now, if this trend is not altered, most workers will come to regard these plans more as an attractive nuisance than as the bulwark of their retirement needs.

You know, the apologists for the current rules govering termination and asset reversions—and apparently they are not in short supply given the huge sums available for relatively easy pickings—they say that you have got to have this type of process; otherwise, the whole voluntary private pension system is threatened.

Well, the crux of the matter is that these overfunded plan terminations are defeating reasonable expectations that participants and beneficiaries have in their minds and we have heard some of this testimony. The expectation of most participants is that a plan is not going to be terminated unless there is a business compulsion to do so. So that when you have these premature terminations, what happens is that it cuts off the ability of employees to be able to earn pensions based upon their entire working career. Their pension benefits are frozen at that point in time. That is a very serious problem. The Department of Labor has estimated that—I think it is $45 out of every $100 in benefits is going to be lost as a result of these premature terminations. If this continues to engulf the entire private pension system, it is going to force employees to rely on defined contribution plans which are much more risky because then your benefit is geared entirely on the investment experience of the plan. It is also going to cause employees to look to the Social Security System and put more pressure on Social Security benefits to be increased and improved to make up for these losses.

Many courts have missed this point because they seem to think that the participants' interest in a terminated plan surplus would be something like a "windfall." They miss this point that what is happening is that employees are being cut off in midstream from their reasonable expectations of what kind of pension they are going to get. Plus the fact, as we have heard, that the retirees lose the capability of being able to get any kind of cost-of-living increase.

In fact, Messrs. Chairmen, I would point out that—and some mention has been made about perhaps enacting some kind of cost-of-living requirement—I would point out that this administration's guidelines, that were ostensibly set up to enable some form of defined benefit plan coverage to continue for active employees, does nothing, absolutely nothing for retirees, besides being inadequate on other grounds.

Let me emphasize that it is highly likely that if private pension plans had been mandated to provide reasonable cost-of-living protection to retiree benefits, as ERISA probably should have required all along, that many of these overfunded plans simply would not have existed because that same inflation that created the surplus is also the inflation that has robbed these retirees of their cost-of-living protection for their benefits. The simple truth is that, in many instances, it is money from the pockets of retirees that has found its way into corporation coffers under the guise of termination reversions.

Now, there are two schools of thought about how to deal with this problem, and we have a controversy as to whether or not the problem should be dealt with at all; whether or not all private pension plans are going to go kaput if we should lay a hand on these asset reversions. It reminds me somewhat of the argument that was made prior to ERISA, in which plan sponsors said,

> Well, now, if you mandate vesting standards and you erect termination insurance and you put in all these fiduciary standards, particularly those which prohibit conflicts of interest, nobody is going to want to have a pension plan.

It didn't happen. The system not only did not go under, but it flourished. So the real question we have to deal with, the real controversy, is how do we deal with this problem and there seems to be two schools of thought. One school of thought says, "Let's concentrate on the termination because the termination is the principal evil. It is the premature plan termination that destroys the legitimate expectations of both active employees, as well as retirees."

Now, the other school of thought is, "Well, if that is the case, let's find some way to enable plan sponsors to obtain the use of surplus assets without having to terminate the plan." It has been suggested by my good friend and colleague, Don Grubbs, that perhaps there should be some way a plan sponsor could, in effect, obtain the excess assets of an ongoing plan which, by the way, currently constitutes an illegal diversion of plan funds. It can't be done.

However, there is authority under ERISA for plan sponsors right now to go to the Department of Labor and ask to borrow these plan funds if they need them. They can ask for what is called a prohibited transaction exemption. Now, a prohibited transaction exemption has to meet certain standards. You have to show that it is administratively feasible; you have to show that it is in the interest of the plan participants and beneficiaries; and you have to show that it is protective of their rights.

If plan sponsors are so interested in protecting participants and beneficiaries against these premature plan terminations and they want to get ahold of these surplus plan assets, why don't they apply right now for a prohibited transaction exemption, and say they need the money, and that it is not necessary for the plan? Well, I suspect that the reason they can't do it, or they won't do it, is because they are not going to get such an exemption. The reason they are not going to get such an exemption is because the withdrawal of sizable plan assets in one fell swoop would unnecessarily weaken the plan's funding of accrued benefits. It would, therefore, be contrary to the interests of the participants and beneficiaries.

I suggest to you that this result should caution us to be very hesitant about legislating any type of procedure that permits an employer of an ongoing plan to strip that plan of so-called excess assets. The fact of the matter is that ERISA's current funding rules have the effect of gradually permitting a plan sponsor to recapture excess assets from an ongoing plan by specifying that these experience gains, as they are technically referred to—that is, investment earnings that are more favorable than those assumed by the plan's actuary—be amortized over a 15-year period.

Such experience gains amount to a credit to the plan sponsor against the plan's liabilities and that reduces the sponsor's funding obligation. That is like money in the bank, only not all at once. At the same time, if there are subsequent experience losses to offset the experience gains, the surplus has the effect of also easing any ongoing funding burden that the employer may encounter down the road, and it protects the plan against possible funding deficiencies during an economic downturn.

This system was carefully crafted by ERISA's authors and no one has demonstrated that it is wrong or that it has failed. To the contrary, because it has succeeded so well, corporate rapacity now threatens to destroy it. If the corporations cannot restrain themselves from plundering experience gains, I think it is high time for Congress to do it for them.

I favor H.R. 2701 because I think that the nub of the problem is to deal with this matter of termination reversions and limit them. Unless you do that, there is no hope, no prayer, for even beginning to consider providing some type of approach for withdrawing assets from an ongoing plan, even assuming that I am wrong, and that such an approach is justified. The reason is that the minute you put safeguards on withdrawing assets from an ongoing plan, all the employer is going to do is terminate it and he can get back the whole thing without any restrictions at all.

That concludes my oral statement.

[The prepared statement of Mr. Gordon follows:]

Messrs. Chairmen and Members of the House Select Committee on Aging and the House Labor Subcommittee on Labor-Management Relations. My name is Michael S. Gordon. I am an attorney practicing in Washington, D.C., who specializes in ERISA and employee benefits law. I am appearing today at your joint invitation to discuss the termination of overfunded pension plans from the perspective of one who, for over ten years, had the rare privilege of participating actively in the legislative process that culminated in the enactment of ERISA. For the record in this regard, let me note that during the period 1970-75 I served under an appointment by Senator Jacob K. Javits (R. N.Y.) as Minority Counsel for Pensions for the U.S. Senate Committee on Labor & Public Welfare. Prior to that, I served as the Department of Labor's counsel to President Kennedy's Cabinet Committee on Corporate Pension Funds and other Private Retirement and Welfare Programs, which, in 1965, issued a report that more or less became the blueprint for ERISA. I should also add that I have had some recent day-to-day experience with a number of overfunded plan terminations. Therefore, my views derive not only from prior legislative background but also from some concrete involvement with the subject.

First of all, I would like to commend both Committees for holding this pathbreaking hearing. There are many issues in the employee benefits field that compete for your attention and there obviously will be differences of opinion as to which ones deserve priority consideration. This hearing demonstrates that the issue of overfunded plan terminations has been put on the front burner where it belongs. Indeed, with all due respect for the numerous proposals for further private pension reforms now pending, a number of which I strongly support, it is my belief that the problem of overfunded plan terminations is the most serious one to appear since the enactment of ERISA. It is becoming increasingly clear that these terminations and their dubious progeny -- the "spin-off" and the "termination-reestablishment" -- are so toxic to the good health and character of the private pension concept that legislating reforms in this area -- as fraught with difficulty as that might be -- should now take precedence over other proposals. Of course, that should not preclude a meaningful attempt to enact both asset reversion and other reforms in an omnibus bill. But the degree of harm caused by these unnecessary terminations requires a prompt Congressional response.

One of the key objectives of ERISA was to restore participant and beneficiary confidence in the integrity of the private pension promise. The sponsors of ERISA wisely foresaw that it was essential that we strengthen worker motivation in order to maintain and promote our Nation's ability to compete effectively in the economic sphere. Only dedicated employees can produce the quality goods and services that will enable us to overtake our economic rivals. But that spirit of dedication cannot flourish when the pensions on which employees rely have been cheapened or subverted by the indiscriminate use of asset reversion tactics.

The same benighted corporate mentality that gave us the $7,400 coffee maker and the $659 ash tray is also giving us the premature pension plan termination so that companies can make off with funds accumulated for the benefit of their employees. The latest word is that if all pending requests for termination approval are granted, $6.2 billion in asset reversions will have been recovered by plan sponsors since 1980 and somewhere in excess of 500 plans of sizeable corporations will have been terminated. There are, and there ought to be, circumstances where it is legitimate for companies to obtain "surplus" plan assets. But the current epidemic of termination-reversions has virtually obliterated the basis for any meaningful distinctions and, unless halted, will so thoroughly discredit the defined benefit plan idea that eventually most workers will come to regard these plans more as an attractive nuisance than as the bulwark of their retirement income needs. They will then be forced to rely on defined contribution or capital accumulation plans which are inherently more risky and unreliable since the benefit the retiring employee obtains is dependent solely on the investment success achieved by such a plan.

The apologists for the current rules governing terminations and asset reversions -- and they are not in short supply given the huge sums available for relatively easy pickings -- say that corporate access to excess plan assets on terminations has been part and parcel of long-standing legal doctrine which has been validated under ERISA and the Internal Revenue Code and should be left alone in order to preserve the voluntary nature of private plans. However, until recently, terminations of overfunded plans represented such a relatively rare and infrequent occurrence that the entire issue was never exposed to prolonged critical attention, not even when ERISA was under consideration. Proposals that might have led to greater regulatory control over termination-reversions were discarded by the principal authors of ERISA simply because there was no great evidence at that time of a significant problem. In this regard, not too long ago I delivered a paper on the legislative history of ERISA's asset reversion provisions before the Pension Research Council of the Wharton School of Finance. This analysis may be of interest to members of both Committees and their staffs and I, therefore, ask unanimous consent that it be included, along with my prepared testimony, in the printed transcript of this hearing.

The crux of the matter is that notwithstanding current law and prior legislative history, participants and beneficiaries have a reasonable expectation that a defined benefit plan will be continued unless some legitimate business necessity compels the employer to abandon it. The mere existence of an overfunded plan condition does not, standing by itself, constitute such a legitimate business necessity in the minds of most impartial observers, and that is why this unfortunate controversy exists and must be resolved. If the voluntary character of private plans hinges on defeating the reasonable expectations of participants and beneficiaries so that management can lay its hands on "excess" plan assets whenever it wishes, then defined benefit plans are not worth the paper they are written on.

Many courts have also missed this point when they refuse to acknowledge the participants' equitable claim to some share of a terminated plan's surplus by characterizing such a claim as an unjustifiable "windfall". This kind of superficial reasoning ignores the fact that absent some share of the surplus, the chances are that many, if not most, of the participants covered by the terminated plan will not earn anywhere near the pension they have been led to believe they would obtain for all their years of service with their employer. A widely-reported draft Department of Labor study appears to demonstrate that terminations of overfunded plans will result in the loss of approximately $45 out of every $100 in anticipated retirement benefits and, of course, inflation-adjustments of retiree benefits from favorable investment experience of the plan are irrevocably impaired by premature plan termination, leaving retirees to the variable whims of corporate largesse.

Proponents of termination-reversions contend that since the company has undertaken the risk of providing, financing, insuring (up to the PBGC's limits) and guaranteeing (up to 30 percent of the Company's net worth) a fixed level of retirement benefits, that it ought to be able to recapture what can be construed as excess contributions not needed to provide the promised benefits. This argument assumes, however, that a premature plan termination is compatible with the public interest in assuring the adequate fulfillment of private pension promises. While the Government does not, and should not, compel private industry to adopt defined benefit plans, once adopted, the government can and must assure that the legitimate expectations of participants and beneficiaries that flow from these plans are fully protected. That principle was established with the enactment of ERISA.

There are a number of other considerations that lead to the conclusion that ERISA inadequately regulates termination-reversions. These include the fact that termination-reversions are now a standard anti-takeover tactic that end up being used to force employees into stock ownership plans they neither want nor control. Suffice it to say that, in my view, the time has long since passed to ask whether ERISA should be amended to curb termination-asset reversion abuses. The real question is what form should the amendments take?

In this regard, a distinct school of thought has emerged which holds that the primary stumbling block to the achievement of a sane termination-reversion policy is the apparent need to terminate a plan in order to safely recapture excess assets. If only an employer could regain the use of excess assets without having to terminate the plan -- so the argument runs -- both the employer and the beneficiaries' interests would be served.

In fact, so as to encourage employers to regain surplus assets without having to terminate their plans, this Administration, in guidelines promulgated in April of last year, has sanctioned the doctrine of the counterfeit termination, which, simply put, holds that if the employer meets certain criteria that the Administration thinks are appropriate, he can pretend that a real termination has occurred and this pretense will receive the Administration's imprimatur and permit the employer to obtain the excess plan assets in an ostensibly legal fashion.

Like most lawyers, I have become inured over the years to the use of legal fictions and I have to concede that the rationale behind the Administration's guidelines has a certain perverse charm that is difficult to resist. If the choice is between a termination-reversion with no possibility of continued defined-benefit coverage and one that permits that possibility, obviously the latter is preferable. However, whether the pretense of a termination takes the form of an Administration-sanctioned "spin-off" or a "termination-reestablishment", such an approach lacks the authoritative qualities needed to make it a permanently useful method of expressing national policy on this matter.

There are several reasons for this conclusion. First and foremost, the guidelines do not purport to regulate termination-reversions which do not seek to continue defined-benefit plan coverage. As long as employers can, without penalty, terminate defined benefit plans for no other reason than to obtain temporarily existing surpluses, the reasonable expectations of many participants and beneficiaries will be frustrated and the problem will not go away.

Second, the intellectual basis of the guidelines conflicts with other important aspects of ERISA policy. If overfunded plans can successfully engage in counterfeit terminations why can't underfunded ones? It is dangerous to presume that courts will always favor form over substance in one transaction but not the other and the attractions of "spinning-off" unfunded liabilities are as great to some plan sponsors as recapture of excess assets are to others. PBGC's insurance exposure would increase inordinately if unwanted liabilities could be "spun-off" successfully, so despite all the hair-splitting distinctions that have been drawn, the guidelines do pose a severe threat to PBGC's litigation posture when that agency challenges the attempted dumping of unfunded liabilities through the "spin-off" technique.

Third, the guidelines rest on a flimsy legal foundation and they do not adequately protect the interests of participants and beneficiaries. If a "spin-off" or a "termination-reestablishment" is a valid form of plan termination, then where is the statutory authority for conditioning agency approval of such a "termination" on compliance with "guidelines"? On the other hand, if a "spin-off" or "termination-reestablishment" is not a valid form of plan termination, then how does compliance with conditions specified in "guidelines" make it valid? Plan sponsors who regard these unorthodox forms of termination as valid but who disagree with some or all of the conditions in the Administration's guidelines have a clear incentive to legally challenge those guidelines and at least two plan sponsors have already done so. Regardless of their outcomes, it is a safe bet that neither the Interco suit against PBGC nor the Celanese Corporation action in the Tax Court, will settle this issue in a definitive way. With billions of dollars in pension fund monies at stake, this is no way to run a railroad.

Finally, as has been pointed out by Chairman Roybal and others, the guidelines are sadly deficient in not requiring credit for past service in successor plans, or providing adequate funding of such plans through the rechanneling of some appropriate portion of the surplus or, most importantly, requiring some part of the surplus to be set aside to provide cost-of-living protection to retirees of the terminated plan whose benefits have not caught up with inflation. It is all very well for the Administration to bootstrap a procedure that claims to secure the interest of active employees in having defined benefit plan coverage continue, but what about retirees? Have they no rights and no standing in the Administration's eyes? Let me emphasize that it is highly likely that if private pension plans had been mandated to provide reasonable annual cost-of-living protection to retiree benefits -- as ERISA probably should have required all along -- many of these overfunded plans would not have existed. The simple truth is that in many instances it is money from the pockets of retirees that has found its way into corporation coffers under the guise of termination-reversions, and it is an injustice that can and should be rectified.

It is possible that the Administration's guidelines could be rescued by appropriately drafted amendments to ERISA and the Internal Revenue Code. It is also possible that other techniques could be legislatively sanctioned that would have the effect of permitting an employer to withdraw surplus plan assets without the necessity of a plan termination. It has been suggested, for example, that an employer could be permitted to withdraw plan assets in excess of the value of accrued benefits as long as (a) the withdrawal was treated as an actuarial loss which would have to be amortized by the employer over a 15-year period, and (b) some cushion of surplus was left behind to guard against unexpectedly adverse experience that might cause the plan's accrued benefits to become underfunded.

However, before leaping to embrace these possibilities, we should be aware of the pitfalls. As long as restrictions are placed on the withdrawal of surplus from an ongoing plan, employers have an incentive to terminate their plans and grab the surplus without regard to the restrictions. Indeed, the stronger the safeguards that are imposed to protect the ongoing plan and its participants and beneficiaries, the greater the incentive to prematurely terminate it. I am firmly convinced that legislation on this subject will be doomed to failure unless it limits, in some reasonable fashion, the right of a plan sponsor to a termination-reversion. Otherwise, employees of the most insensitive plan sponsors will continue to have their legitimate pension expectations defeated, as they are being defeated now.

In addition, by placing decent limits on termination-reversions, we will assist greatly those plan sponsors with currently overfunded plans, who are ripe targets for takeover artists, and who feel they must engage in termination-reversions in order to block a takeover aimed at converting excess pension fund assets to the use of those attempting the takeover. Since the same limits on termination-reversions would apply to groups attempting to take over a company with an overfunded plan, the net effect would be to discourage such takeovers and maintain the continuation of the target company's defined benefit plan. I think that is a highly desirable objective.

For these reasons, I favor the approach taken in Chairman Roybal's bill, HR 2701, which provides that an employer can only gain access to excess plan assets through a plan termination that was caused by business necessity. While preserving the right of an employer to terminate its plan when it chooses to do so, the enactment of this bill would bring the current wave of termination-reversion abuses to a crashing halt, would restore confidence in the integrity of the defined-benefit plan promise, and, at the same time, would enable employers to obtain excess plan assets in legitimate circumstances.

Moreover, the Roybal bill has the virtue of logically following in the footsteps of some prior regulatory precedent. Long-established IRS rules state that the abandonment of a pension plan a few years after its establishment for reasons other than "business necessity" raises a presumption that the plan was not intended to be a bona fide program and may lead to plan disqualification. See 26 CFR § 1.401-1(b)(2). Thus, for example, if an employer in a healthy financial condition terminated his pension plan within a few years after its creation solely to obtain an asset reversion, the plan would be a candidate for IRS disqualification. The Roybal bill does not go this far since it only affects the distribution of the terminated plan's assets and not the tax status of the plan itself. Nonetheless, the rationales involved are related since the Roybal bill operates on the premise that public policy should discourage the premature termination of a long-standing plan for reasons other than business necessity, i.e. when the employer's sole purpose is to obtain excess plan assets. Indeed, members of long-standing plans probably need this protection even more than those in short-term plans since the former, as opposed to the latter, have built their working careers around the presumed durability of the pension plan.

If the premise of HR 2701 is accepted, then it becomes feasible to also consider whether, subject to certain safeguards, an employer should be able to obtain excess plan assets from an ongoing plan. Ratifying some version of the Administration's guidelines through legislation has no appeal in this connection because, by definition, the plan does not have to be terminated. On the other hand, the approach of permitting the employer to withdraw and amortize the surplus over a 15-year period appears more plausible, but it raises many troublesome issues. If surplus plan assets are not really needed to safeguard the funding of accrued benefits, then why does the employer have to pay back these assets? Why can't the employer obtain the surplus assets outright, subject to leaving in an appropriate cushion to handle adverse experience contingencies?

Conversely, if withdrawal of the surplus assets would weaken the funding of accrued benefits, then why should the plan sponsor be able to withdraw such assets, whether or not he amortizes the withdrawal over 15 years? In this regard, it should be noted that ERISA's fiduciary provisions expressly prohibit a loan of plan assets to a plan sponsor unless the sponsor applies for, and receives, a prohibited transaction exemption, which exemption must be based on a showing that it is (a) administratively feasible, (b) in the interests of the plan's participants and beneficiaries, and (c) protective of their rights. If a plan sponsor wants to borrow a surplus, why can't he do it right now by applying for an exemption? Frankly, I don't see much of a distinction between withdrawal of surplus with an amortization payback feature of 15 years, and a direct loan by the plan of the surplus with some comparable repayment period.

If a plan sponsor did apply for an exemption in order to directly borrow plan assets that represented a surplus, the chances are that he would never get the exemption because the withdrawal of sizeable plan assets in one fell swoop would unnecessarily weaken the plan's funding of accrued benefits and, therefore, be contrary to the interests of participants and beneficiaries. This result should caution us to be very hesitant about giving support to any approach that would authorize the stripping of excess assets from an ongoing plan. In the last analysis, these approaches run counter to the thrust of ERISA's fiduciary principles and probably the tax code as well and are only necessary as a means of enticing plan sponsors to avoid premature plan terminations. If premature plan terminations are regulated appropriately, as under HR 2701, then enticement is not an essential, much less desirable, component of regulatory policy.

Moreover, the argument that regulating termination-reversions will discourage sound funding is pure hyperbole. It is not advance funding techniques that accelerate employer contributions in early plan years that has led to these abnormally great surpluses, but rather an unusual economic period characterized by high fixed-interest rates followed by a rampant bull market. No actuary worth his salt would recommend changing to less conservative funding methods on the ground that the next thirty or forty years of funding will be characterized by a constant repetition of these events. Accordingly, placing stricter controls on termination-reversions should in no way diminish the rationale for conservative funding, but it will prevent plan sponsors from taking unjustified advantage of these unusual circumstances.

ERISA's current funding rules have the effect of gradually permitting a plan sponsor to recapture excess assets from an ongoing plan by specifying that experience gains (e.g. investment earnings more favorable than those assumed by the plan's actuary) be amortized over a 15 year period. Such experience gains amount to a credit to the plan sponsor against the plan's liabilities which reduces the sponsor's funding obligation. That is like money in the bank, only not all at once. At the same time, if there are subsequent experience losses to offset the experience gains, the surplus has the effect of also easing the employer's ongoing funding burden and protecting the plan against possible funding deficiencies during an economic downturn.

This system was carefully crafted by ERISA's authors and no one has demonstrated that it is wrong or that it has failed. To the contrary, because it has succeeded so well, corporate rapacity now threatens to destroy it. If the corporations cannot restrain themselves from plundering experience gains, then it is high time Congress did it for them. The next step is the mark-up of HR 2701, and it should be undertaken as expeditiously as possible.

Legislative and Regulatory History of the Asset Reversion Provision in ERISA

[Remarks Prepared for Delivery by Michael S. Gordon, Esq., Washington, D.C., Before the Pension Research Council Symposium on "Recapture of Excess Assets in Defined Benefit Plans", Wharton School of Finance, University of Pennsylvania, May 11, 1984]

Introduction

Section 4044(d)(1) of ERISA permits a defined benefit plan sponsor to recover excess plan assets on plan termination if (1) all liabilities of the plan to participants and their beneficiaries have been satisfied, (2) the distribution would not "contravene any provision of law", and (3) the plan provides for a reversion in such circumstances. However, Section 4044(d)(2) limits reversions in the case of contributory plans by requiring excess assets attributable to employee contributions to be "equitably distributed to employees who made such contributions (or their beneficiaries) in accordance with their rate of contributions."

Reversions that meet the requirements of Section 4044(d)(1) and (2) are excepted from the ERISA provision requiring that plan assets never inure to the benefit of any employer and that they be held for the exclusive purposes of providing benefits to plan participants and beneficiaries and for defraying reasonable plan administrative expenses. See ERISA Section 403(c)(1). In addition, the reversion rules of Section 4044 apply to the termination of pension plans to which the Title IV coverage provisions are inapplicable "except as otherwise provided in regulations of the Secretary [of Labor]." See ERISA Section 403(d)(1). Finally, ERISA Section 404 makes the general rules pertaining to fiduciary duties subject to the exceptions and specific rules covering reversions previously specified, and ERISA Section 408(b)(9) exempts from the prohibited transaction provisions reversions that satisfy Section 4044.

It is quite clear from the foregoing that ERISA generally permits a defined-benefit plan sponsor to recapture excess plan assets on plan termination. However, in the wake of the public reaction against the recent wave of asset reversions, questions have been raised concerning the degree to which Congress fully debated or understood the policy behind Section 4044. Those who endorse amending ERISA to restrict asset reversions point out that nothing like the current trend of overfunded plan terminations occurred during the period that ERISA was evolving and that Congress was preoccupied with underfunded plans and the need to provide further protections in this respect. It is also noted that the Congressional disposition in 1974 to do something new and different about asset reversions in the case of contributory plans signifies that Congress would have acted more vigorously in the case of non-contributory plans had the present situation existed then.

On the other hand, spokesmen for this Administration as well as others who oppose legislative efforts to revise Section 4044, contend that the subject of asset reversions had been fully considered by Congress prior to enacting ERISA, that alternatives that would have prohibited such reversions were rejected, and that the policy permitting asset reversions was of long standing under the Internal Revenue Code prior to ERISA, which Congress had no inclination to disturb then, and, therefore, should not disturb now.

For my part, I find a great deal of truth in the positions asserted by both sides and I am fairly certain that the current controversy over asset reversions will not be resolved on the basis of either of them. What Congress might or might not have done in 1974 if they had been confronted with significant numbers of terminated overfunded plans is interesting to speculate about but no more than that. Similarly, the 1974 Congressional authorization for asset reversions, however long and respectable the tradition behind it, was not written in stone; it is a policy that now needs to be reviewed and revised if found to be wanting.

While the nuances of legislative history will not resolve the underlying conflict between opponents and proponents of asset reversions, it may shed light on some of their concerns. What follows is a highly condensed reprise of the ERISA legislative history concerning asset reversions, some of it based on personal notes or recollections dating to the time I was Minority Counsel for Pensions to the U.S. Senate Labor & Public Welfare Committee when ERISA was being drafted. Obviously, the material that is anecdotal has no official status nor do I claim that my version of events would necessarily be shared in all particulars by others who participated in the drafting of ERISA. In addition, I should acknowledge the possibility of some personal bias on this subject in view of the fact that the law firm with which I am associated represents participants who have sued a plan sponsor to overturn an asset reversion and because I have previously taken a public position in favor of amending ERISA to place further restrictions on asset reversions. I believe these are all the pertinent disclaimers and disclosures, so let us proceed.

Origins of the Asset Reversion Provision in Section 4044

There are three significant occurrences in connection with development of the asset reversion provision which are, in my view, worthy of attention. The first pertains to the inclusion of an asset reversion provision in the bills that were the forerunners of ERISA; the second pertains to the Elgin Watch Company case, which resulted in the adoption of the special rule for contributory plans in Section 4044(d)(2); and the third deals with adoption of that mystifying provision of Section 4044(d)(1)(B) — that the distribution of excess assets "not violate any provision of law."

Early Asset Reversion Provisions

The origins of the asset reversion provision derive almost exclusively from Senate consideration of pension reform legislation. Both in the 91st and the 92nd Congress, Senator Javits introduced comprehensive private pension reform bills (S. 2167 and S. 2 respectively) which contained asset reversion authority. S. 2, for example, in its fiduciary provisions, specifically provided that:

> "any assets of the fund remaining upon dissolution or termination of the fund shall, after complete satisfaction of the rights of all beneficiaries to benefits accrued to the date of dissolution or termination, be distributed ratably to the beneficiaries thereof or, if the trust agreement so provides, to the contributors thereto." See Section 402(b)(1)(C) of S. 2, 117 Cong. Rec. S85, January 25, 1971.

What is interesting here is that no attempt was made to amend or refer to the Internal Revenue Code; S. 2 was regarded as a "labor law." The draftsman of S. 2 incorporated as "labor law" the principles of trust law then extant, i.e. unless the plan specifically provided for distribution of surplus assets to participants and beneficiaries such assets would revert to the sponsor. See e.g. Lefferdink v. Baker, 156 Colo. 457, 399 P.2d 935 (1965).

Was the draftsman unaware of the reversion rules under the Internal Revenue Code? Quite the contrary. The whole point was to steer clear of "tax law" so as to assure that the bill not only would be referred to the Senate Labor Committee but would avoid the charge that the Javits bill was incompatible with existing tax law.

Was the draftsman aware of the prior legislative history of the tax policy on reversions and did he undertake an independent review of that policy to determine its soundness? Not really. The draftsman may or may not have been aware that in 1938 there was conflict between the Senate and House over whether a pension trust should be tax exempt if the plan sponsor could revoke the trust and recapture plan assets.*/ But it didn't matter. At the time, no one was complaining over the policy and both trust law and tax law appeared settled on the point. Why not let sleeping dogs lie?

The asset reversion provision of the Javits bills was carried over intact into Section 15(b)(1)(C) of S. 3598, the joint Williams-Javits bill that was negotiated between the staffs of Senator Javits and Senator Williams in late 1971 and early 1972, introduced on May 11, 1972 and reported by the full Committee on September 15, 1972. See: Part 1, Hearings on S. 3598, Retirement Income Security for Employees Act, 1972, before the Subcommittee on Labor of the Committee on Labor & Public Welfare, 92d Congress, 2nd Sess., June 20 and 21, 1972 at p. 72; 118 Cong. Rec. S. 17737 (Oct. 12, 1972).

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*/ The House had passed a provision amending the tax law to make a revocable pension trust subject to tax but the Senate version had sanctioned the tax-exempt status of a revocable pension trust as long as it was impossible "prior to the complete satisfaction of the pension liabilities with respect to employees under the trust" to divert any part of the trust fund for any purpose other than for the exclusive benefit of the employees. The House receded in favor of the Senate version. See Conference Committee Report, H. Rept. 2330, 75th Cong. 3rd Sess. at p. 45 (1938). See also, H. Rept. 1860, 75th Cong. 3rd Sess. at pp. 46-47 (1938), and S. Rept. 1567, 75th Cong. 3rd Sess. at p. 24 (1983).

At this juncture there was very little discussion between the staffs on the asset reversion provision. The Williams staff accepted the rationale of the Javits staff for the provision. Interestingly enough, and contrary to current belief, in its investigation of pension funds in 1971, the Subcommittee on Labor had uncovered examples of overfunded plans and had heard testimony from two of them, the plan of the Kendall Co., Boston, Mass. and Joseph Horne Co., Pittsburgh, Pa. See Part 2, Private Welfare & Pension Plan Study, 1971, Hearings Before the Subcommittee on Labor of the Committee on Labor & Public Welfare, U.S. Senate, 92nd Cong., 1st Sess., October 12 and 13, 1971 at pp. 805 and 843 respectively. A careful examination of that testimony, and especially the dialogues between committee staff and plan representatives indicate rather clearly the staff suspicion that overfunded plans were the product of an excessive forfeiture rate among plan participants due to lack of adequate vesting, the implication being that if vesting standards were federally mandated, overfunded plans — rare as they were in 1971 — would disappear altogether. This conclusion may appear naive at present but it authentically represents the prevailing state of mind at the time the Williams-Javits bill was drafted, and helps to explain what now seems to be a singular lack of focus on the potential problems of asset reversions.

The Elgin Watch Company Case

S. 4, the successor to S. 3598, was introduced in 1973, with the same asset reversion provision. At the same time, S. 75, a pension reform bill introduced by Senator Robert Griffin of Michigan contained a slightly different provision authorizing asset reversions which made specific reference to the Internal Revenue Code. It read as follows:

> Each employee benefit plan shall contain specific provisions for the disposition of its fund assets upon termination. In the event of termination, whether under the express terms of the plan or otherwise, such fund, or any part thereof, shall not be expended, transferred or otherwise disposed of, except for the exclusive benefit of the plan participants and their beneficiaries and, if applicable, in accordance with the provision of title III of the Employee Benefits Protection Act of 1973. Notwithstanding the foregoing, after the satisfaction of all liabilities with respect to the participants and their beneficiaries under an employee pension benefit plan in accordance with the Internal Revenue Code of 1954 and regulations promulgated thereunder, any remaining fund assets may be returned to any person who has a legal or equitable interest in such assets by reason of such person or his predecessor having made financial contribution thereto.

See "Section 14(f)" inserted by Section 110 of S. 75, Retirement Income Security for Employees Act, 1973, Hearings before the Subcommittee on Labor & Public Welfare, 93rd Congress, 1st Sess., Feb. 15 & 16, 1973, at p. 132.

The staff of the Labor Committee did not care for the reference to the Internal Revenue Code in the Griffin bill (the year before the Senate Finance Committee had stripped S. 3598 of all its essentials in a jurisdictional power-play and had effectively prevented S. 3598 from reaching the Senate floor) and recognized that adoption of Griffin's provision might hurt the Labor Committee position in the event of another showdown with the Finance Committee.

Both S. 4 and S. 75 were pending when the Senate Labor Subcommittee heard testimony from Senator Adlai Stevenson on the Elgin Watch Company case, which was the first time an asset reversion "abuse" situation had been brought to the Subcommittee's attention. See Retirement Income Security for Employees Act, 1973, hearings, supra at p. 193 et seq.

In this case, Elgin Watch Company had not contributed to the plan since 1958 because the plan was discovered to be overfunded. No doubt further contributions would have not received tax deduction treatment and might have jeopardized the tax-exempt status of the plan. On the other hand, since it was a contributory plan, employees continued to contribute to it and since the domestic watch industry was dying the number of employees covered by the plan had declined to a handful. Nonetheless, the plan continued on without IRS seeking to suspend or declare it terminated. The combination of investment success by the plan plus dwindling coverage and the continuation of employee contributions resulted in a plan surplus of $12 million which the company proposed to recapture by terminating the plan in 1971 or 1972. The remaining plan participants were outraged, believing that all or part of the surplus belonged to them.

Stevenson argued that the Elgin Watch Company case was the tip of the iceberg and that all asset reversions should be precluded, not just those involving contributory plans. In fact, I'm not sure that in his mind he drew much of a distinction between one or the other. Stevenson's staff circulated proposed draft amendments that would have required all surpluses to be distributed to employees, and for a brief period there was a rush of sympathy for Stevenson's position in the Committee.

On sober reflection, Stevenson's position was rejected behind the scenes not for doctrinal reasons but for pragmatic ones. It was felt to be unwise to challenge a long-standing policy that was sanctioned under the Internal Revenue Code in the absence of further evidence of abuse. Such a challenge would provide too much ammunition to enemies of pension reform in the Senate Finance Committee. Moreover, Stevenson had only demonstrated abuse in a contributory plan; nothing had been shown in non-contributory plan situations. Even in contributory situations, the rule was against the Elgin Watch Company participants obtaining anything other than their benefits (which included a return of their contributions). See Lefferdink v. Baker, supra, which held that participants in a terminated contributory plan were not entitled to the surplus or any portion thereof. Accordingly, fashioning a rule to deal with what amounted to Stevenson's constituent problem was sufficient unto the day and when informed of that decision Stevenson did not resist. He got what he needed politically and that was that.

Thus, S. 4 as reported by the full Committee now contained a new provision which was identical to what now appears in Section 4044(d)(2) of ERISA. That provision was known as the "Elgin Watch Company provision."

The Distribution Must Not "Contravene Any Provision of Law"

With one exception, from the time S. 4 was reported until the last stages of the Conference Report there was very little significant change in the asset reversion provision. S. 1179, the bill reported by the Finance Committee on August 21, 1973, contained no general reversion authority and failed to deal with the Elgin Watch Company case, but did sanction asset reversions as an exception to the prohibited transaction provisions. I Leg. Hist. at 973.*/ Nonetheless, the asset reversion provision as passed by the Senate on September 19, 1973 in the combined Labor Committee-Finance Committee vehicle tacked on to H. R. 4200 was identical to S. 4 as reported, see I Leg. Hist. 1441-42, but contained no asset reversion exception from the prohibited transaction provisions. By way of contrast, in the House, H.R. 2, as introduced by Congressman Dent on January 3, 1973, contained a provision -- Section 111(e) -- which precluded asset reversions to the employer. See I Leg. Hist. at 44. When H.R. 2 was reported, however, a new Section 112 appeared which generally reflected the sum and substance of S. 4 - H.R. 4200 but with certain variations not especially germane to this discussion. See II Leg. Hist. at 2294-2295 and 2369.

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*/ The references in this paper to "Leg. Hist." are to the three-volume Senate Committee Print of the Legislative History of ERISA prepared by the Subcommittee on Labor, U.S. Senate Committee on Labor and Public Welfare, 94th Cong., 2d Sess. (1976).

H.R. 2, as passed by the Senate on March 4, 1974, contained the same asset reversion provision as S. 4 - H.R. 5200, see III Leg. Hist. at 3773, but also contained a new asset reversion exception to the prohibited transaction provisions which read as follows:

> (J) Distribution to Employer -- It is not a prohibited transaction for a fiduciary to make a distribution of the residual assets of the trust in accordance with the terms of the plan, and not in contravention of existing law, to the employer who maintains the plan after all liabilities of the plan with respect to participants and their beneficiaries have been satisfied, except that any assets of the fund attributable to employee contributions, remaining after complete satisfaction of the rights of all beneficiaries accrued to the date of dissolution or termination, shall be equitably distributed to the employee contributors according to their rate of contribution.

See III Leg. Hist. at 3793 (emphasis added).

It is clear that the form of this provision derived from S. 1179 and had been amplified to pick up the general reversion authority language, including the Elgin Watch clause pertaining to contributory plans. But something new had been added. For the first time, and only in the context of an exception to prohibited transactions, there was a requirement that the distribution of reversionary assets not be in "contravention of existing law."

My notes indicate that it was not until the Conference Committee deliberations that this new phraseology caught my attention. At the time, the reintroduction of an additional exception to prohibited transactions was what mattered. The draftsmen for the Senate Finance Committee felt that legal symmetry required both an asset reversion exception in the general fiduciary provisions and the prohibited transactions provisions and the Senate Labor Committee staff acquiesced. I have no record of a discussion on this subject involving the principals.

Thus, the version that was enacted in the Conference Report basically represents H.R. 2 as passed by the Senate on March 4, 1974 with major sylistic changes, the principal one being the transfer of the asset reversion authority to the allocation of assets provision in Title IV and the various incorporations by reference in the fiduciary and prohibited transaction provisions. The Section 4044(d)(1)(B) requirement that a distribution of "residual assets" not contravene "any provision of law" (as contrasted with not contravene "existing law") is not explained by the Conference Report and was not specifically discussed in conference.

Who wanted the "any provision of law" language and why? My notes indicate that it was requested originally by the staff of the Joint Committee on Taxation — the professional tax resource of both Houses of Congress -- who were concerned that there were certain possible types of reversion cases involving fraud or constructive fraud which the Internal Revenue Service could not or thought it could not reach because they didn't involve tax fraud but which might be otherwise actionable under state law. I have no idea what those cases were and why they were untouchable under the Code. Those who want the answers will have to pursue the former members of the Joint Committee staff who were responsible for this addition.

If my recollection is accurate -- and I believe it is -- it indicates that the meaning of "any provision of law" is far broader than the meaning ascribed to it by representatives of the Department of Labor, who testified before the House Aging Committee last fall that the phrase was limited to violations of ERISA and the Internal Revenue Code rules on distribution of assets.

That explanation doesn't make any sense since it would have been easy to use specific language to reach that narrow result if such a result had, in fact, been intended. Moreover, would exclusion of the "any provision of law" language have made any difference in this regard? What other provisions of ERISA were implicated aside from those already tied to Section 4044 and if there were any, why wouldn't they have been specifically dealt with as was the case with the other incorporations by reference?

As far as the Internal Revenue Code is concerned, the Code's provisions (and regulations thereunder) concerning reversions would have been and were left intact since the Code was not amended in this connection. Section 4044 constitutes a "labor law" overlay on those provisions. Is it logical to assume that the drafters intended to connect "any provision of law" only to the IRS rules forbidding distribution of terminated plan assets in a manner that discriminates in favor of the higher paid but not to the key concept of "actuarial error"? Why one and not the other? Yet, there is no mention of "actuarial error" as a predicate to a reversion in any of the discussions regarding Section 4044, all of which tends to reinforce the impression that the Code provisions were always intended to operate independently of Section 4044 and that the draftsmen had other things in mind as the objective of the "any provision of law" clause.

In this connection, it should be noted that the preamble to PBGC's regulations on Allocation of Residual Assets, 28 CFR § 2618.30 (46 FR 49845), October 8, 1981, read as follows:

> Section 2618.30 provides that residual assets that are not attributable to employee contributions may revert to the employer if the plan provides for reversion and the distribution does not violate any provision of law. This provision reflects the language in section 4044(d)(1) of the Act. One comment noted that the phrase "the distribution does not violate any provision of law" is too restrictive and dis-

> regards judicial elucidation and equity. It was suggested that the regulation require that "the distribution does not violate law or equity" and that "a good faith determination to terminate has been made under the fiduciary standards" of the Act. PBGC believes that the regulation should not, and need not, go beyond the statutory language. The allocation process is separate from any judicial remedies based on equity or violations of the fiduciary standards of the Act. Moreover, PBGC believes that "provision of law" includes judicial interpretation of written laws and does not preclude a court from exercising its equitable powers. PBGC further notes that the provisions on fiduciary responsibility and the enforcement of fiduciary responsibilities are found in Title I of the Act and are not within PBGC's jurisdiction.

The underlined phrase in the foregoing preamble comes the closest to expressing what the Joint Committee staff probably had in mind when it asked for the inclusion of the "provision of law" clause, particularly when one considers that the clause originated as part of an exception to prohibited transactions. Conversations with Department of Labor officials reveal that the Department's real motivation in adopting a narrow view of the clause is their wish to avoid what they perceive as potentially open-ended inquiries into non-pension law violations that may affect a termination-reversion.

At this stage, the Department's concerns are more theoretical than real on this score, and taking what is tantamount to a non-enforcement position when evidence is presented that fraud or undue influence, for example, may have played a role in triggering a termination-reversion is unwarranted. The Department's "hands-off" policy not only is inconsistent with traditional equitable principles — which require voiding a revocation of trust procured by fraud or undue influence*/ -- but has contributed to the public impression that abusive asset reversions cannot be regulated under ERISA at all. This reaction has, in turn, led the Department, and, indeed, this Administration, to advocate legally doubtful techniques, such as "spin-offs" and raising certain non-terminations to the status of terminations, in order to entice plan sponsors not to commit potentially "abusive" termination-reversions.

It may well be that legislative amendments to ERISA are now needed to limit generally the circumstances under which asset reversions can take place -- and this might have been true anyway given recent trends -- but it cannot be gainsaid that the Department of Labor's feeble interpretation of the "provision of law" clause -- an interpretation that finds very little support in the legislative history -- has contributed heavily to the current upsurge of interest in such amendments.

Conclusion

Those who are looking for a "smoking gun" in these remarks will be disappointed. There really isn't any. The legislative history of the ERISA asset reversion provision discloses only an ordinary effort to make just those changes in pre-existing law that were regarded as necessary and no more. With the exception of the Elgin Watch Company provision, this resulted in essentially carrying over pre-existing law permitting termination- reversions. Moreover, despite the debate surrounding the Elgin Watch Company case, tactical legislative considerations more than any other factor were responsible for limiting the scope of what ultimately became Section 4044(d).

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*/ See e.g. Bogert, Trusts and Trustees, § 1001 at 493 (2d ed. 1962); Cloud v. United States National Bank of Oregon, 280 Ore. 83, 570 P.2d 350 (1977).

Lawyers know that both sides to an issue can usually find enough material in the legislative history of any statute to support their respective points of view. Still, it is difficult not to conclude that none of the major asset reversion issues now being widely debated were recognized or given anything other than superficial consideration when the subject arose in connection with the evolution of ERISA. Efforts now being made to characterize the ERISA discussion of the matter as a major ideological confrontation in which, once and for all, proponents of termination-reversions succeeded in establishing the supremacy of their position, seem to me to be wildly inaccurate.

On the other hand, some of the implications of Section 4044(d) appear to have slipped by unnoticed. The Elgin Watch Company provision abruptly changed the rules of the game in regard to contributory plan reversions and yet the roof hasn't fallen in. I mean there has been no demonstration that the growth of contributory plans has declined or that their funding has become less conservatively-based as a result of ERISA requiring that a fair portion of excess assets be returned to the employee-contributors. Would the same hold true if a similar rule was now enacted for non-contributory plans? If we judge by the rhetoric of non-contributory plan sponsors and their allies, the answer is a resounding "no," but they may not have the last word on this subject. That belongs to public opinion and the battle for the favor of that opinion has only just begun.

Mr. **Roybal**. Thank you, Mr. Gordon.

Today's record will be open for approximately 3 more weeks, so I am not going to ask any questions of the panel, but I am going to make this suggestion and would appreciate your response, if you are willing to participate.

H.R. 2701 has a provision whereby it does not abolish or prohibit terminations. It does, in fact, allow it under various conditions where a business necessity exists.

I would like to make available a copy of H.R. 2701 to each member of this panel and ask that you respond, making your recommendations as to how that piece of legislation can be improved. Your response will be included in the record as if you had answered the question right at this time.

Would you gentlemen be willing to participate in that program?

Mr. **Gordon**. Happy to do so.

Mr. **Grubbs**. Yes, sir.

Mr. **Marshall**. Yes, Mr. Chairman.

Mr. **Roybal**. The answer is yes on the part of all three.

I thank you very much. I think it would be most helpful because we have to depend on experts in the field in order to bring about changes in legislation. We usually draft the legislation after talking to experts, however, the more experts we get, I think the better the legislation will be.

The Chair now recognizes Mr. Saxton.

Mr. **Saxton**. Thank you, Mr. Chairman.

I would like to just start by asking Mr. Marshall whether or not—one of the important parts of your statement was that you expressed the fear that perhaps this House or the Government would in some way impose restrictions on the use of moneys that would be so prohibitive that they would in some way discourage companies, corporations, from establishing plans voluntarily.

I was wondering if you have communicated with other segments of the business community relative to that concern and whether it is shared on an industrywide basis?

Mr. **Marshall**. As stated, Congressman, that is the position of the Association of Private Pension and Welfare Plans, an organization that includes 475 private plan sponsors.

Mr. **Saxton**. The Chamber of Commerce Business Roundtable?

Mr. **Marshall**. I have had no direct contact with them on that subject.

Mr. **Saxton**. Don Grubbs, have you had an opportunity to look at Chairman Roybal's proposal?

Mr. **Grubbs**. No, I haven't looked at the bill. I looked at the previous bill that he had and I confess that I don't recall all the details of it.

Mr. **Saxton**. My line of questioning, frankly, Mr. Chairman, was to try to draw a comparison between Mr. Grubbs' proposal and your proposal and I think that perhaps that best be left to another day.

Mr. **Roybal**. I think you will find, Mr. Saxton, that we are not very far apart.

The Chair now recognizes Chairman Clay.

Mr. **Clay**. Thank you, Mr. Chairman.

I would like to pose the same question to each of you that I posed to Mr. Seidman. This money that is being taken out of the funds, in your opinion, who does that money belong to? Each one of you just——

Mr. **Marshall**. In my opinion, it is clear that excess assets are the assets of the employer at termination, after full provision has been made for then-payable benefits to both retirees and others who might terminate employment at the same time.

Mr. **Clay**. Mr. Gordon?

Mr. **Gordon**. Mr. Chairman, I think that under current law, the rule is that on termination, assuming all plan liabilities are satisfied and a couple procedural requirements are met, that, with the exception of that portion of the surplus which is derived from employee contributions, as opposed to employer contributions, that the employer may recapture the surplus.

Now, if you are asking who should it belong to, I think we have a different answer, and I think that what Congress did in 1974 by changing the rules of the game—I want to emphasize this—by changing the rules of the game with respect to the surplus insofar as employee contributions were concerned, indicates that there really isn't that much of a distinction regarding employer contributions since pensions are a form of deferred wages, as Mr. Seidman said, and since these funds are dedicated for the use and benefit of participants and beneficiaries. Therefore; they cannot be regarded exclusively as the employer's province. It may well be that some portion of that surplus the employer be entitled to, but to go beyond that and then say, well, that automatically means that the employees and retirees have no entitlement at all, that I think is equally wrong. There is a double interest, a duality of interest in it, and let me explain, to make this point clear, that prior to ERISA, courts permitted employers to recapture that portion of a surplus that derived exclusively from employee contributions. How inequitable can you get? Yet that was the state of the law prior to ERISA. ERISA changed that.

When the question came up as to whether or not it should go further than that, the answer was, in the absence at that time of specific abuses of the kind that we are seeing now, that the line would be drawn at the contributory portion of the surplus, but as a matter of philosophy, if you will, there is really not that much difference between that portion which the employee has contributed out of his own pocket and that which he has foregone by way of deferred wages which the employer contributes on his behalf.

Mr. **Clay**. Thank you.

Mr. Grubbs.

Mr. **Grubbs**. With regard to present law, I certainly concur with Mike Gordon, that the employer is entitled to recover excess assets except to the extent that the excess is attributable to employee contributions. With respect to who they equitable belong to, I think that varies greatly with the type of plan. If one has a collectively bargained plan where the cost of the plan has been taken into account in collective bargaining such as a plan costing 80 cents per hour for which employees accept 80 cents per hour less in the paycheck, there is a good argument that any excess belongs to employees under the plan.

With respect to plans that are not collectively bargained, though, the employer ordinarily promises to provide a level of benefits. The employer has flexibility in the extent to which he funds the plan. If the employer puts in more than required to give extra security to the benefits and if that is more than enough, I think clearly in terms of justice, any excess should go back to the employer. It is not a clearcut—there is no clearcut answer to the question.

Mr. CLAY. Thank you.

Did you want to comment further?

Mr. GORDON. Yes; I think, again, the nub of the problem is premature termination. We are dealing with a condition, not a theory, and if an employer can prematurely terminate a plan for no other reason than to get excess assets, then even assuming that Don Grubbs is correct, and that all liabilities are taken care of, if he can do that and destroy the reasonable expectations of participants and beneficiaries who have predicated their working careers on receiving much more based upon the durability of the plan—in other words, the employer can pull the rug out just like that and that is essential to the success of the defined benefit plan system, then I suggest, respectfully, that defined benefit plans are going to be shunned in the future.

Mr. CLAY. Thank you.

Thank you, Mr. Chairman.

Mr. ROYBAL. Thank you, Mr. Clay.

Mr. Fawell.

Mr. FAWELL. I have only one short comment and then one question for Mr. Marshall.

The question, though, is what in the world is premature termination and that is what we are struggling with and that is where we haven't been given the handle to as yet to really solve this question. Everybody has their own ideas in that regard, but Mr. Marshall, in your statement on page 6, you say that—and I quote: "The APPWP views with alarm the legislative proposals which would change the current incentives that exist for defined benefit plans."

Is the APPWP opposed to any legislation in this area or are there certain changes not yet proposed that might address the inequities in regard to which we certainly have been discussing this morning?

Mr. MARSHALL. Congressman, we welcome and will respond to Congressman Roybal's offer to review H.R. 2701 and provide commentary that I think would address that question.

[See appendix V for followup testimony subsequently received.]

Mr. FAWELL. No further questions, Mr. Chairman.

Mr. ROYBAL. Thank you, Mr. Fawell.

I would like to thank the members of this panel for their very excellent testimony. Thank you very much.

The next witness is Mr. David Walker, who is the Acting Director of the Pension Benefit Guaranty Corporation. Will Mr. Walker please take his respective chair and proceed, Mr. Walker, in any manner that you may desire.

STATEMENT OF DAVID WALKER, ACTING EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION AND OTHER FEDERAL AGENCY OFFICIALS

Mr. **Walker**. Thank you, Mr. Chairman.

I am pleased to appear before the joint committee today, to present a statement on behalf of the administration with regard to the complex and no doubt controversial subject matter of asset reversions to employers under the Retirement Income Security Act of 1974.

Mr. Chairman, I have submitted a lengthy statement which I would like to be submitted for the record.

Mr. **Roybal**. Without objection, that will be ordered. Your statement will appear in the record and we would ask you now to summarize.

Mr. **Walker**. On that basis, Mr. Chairman, I would like to summarize the most important aspects of that statement, and incorporate some brief responses to some of the testimony that has been given before me.

First, I feel that it is important to briefly discuss the related provisions of current law and the trend in reversion activity as a prelude to my discussion of the administration guidelines and related comments.

With regard to current law, the Congress decided, in passing ERISA in 1974, that one key to better protecting the benefits promised to participants in defined benefit plans was to encourage better and more responsible funding of these plans. Thus, ERISA requires employers to contribute sufficient assets to their plans to meet statutory minimum funding standards. If, however, contributions and their accumulated performance prove to be greater than that needed to provide all promised benefits, then section 4044(d) of ERISA explicitly allows the plan's sponsor to reclaim any surplus assets that exist if, and only if, the plan is terminated and certain conditions are met.

One of these conditions is that the plan must provide expressly for a reversion to the plan's sponsor on termination. As a followup to some previous comments, I am unaware of any reason why such a point could not be collectively bargained.

With regard to the trend in reversion activity, since August 1982, there has been a significant increase in the number and magnitude of terminations resulting in reversions to plan sponsors when compared to prior historical levels. Many of these, in fact, are due to unusual economic events which may or may not recur in the future.

Despite this dramatic increase from historic levels, I feel it is important to put the total activity in perspective. The chart the committee has prepared displays a dramatic rise in termination activity since 1980. However, in the aggregate, between January 1980, and May 31, 1985, the PBGC has issued notices of sufficiency which would authorize the distribution of plan assets after the satisfaction of liabilities, to some 508 terminated plans with asset reversions in excess of $1 million or more for a combined total of $4.9 billion.

Another 221 cases were pending at the PBGC as of May 31, 1985, which involved another $1.8 billion in surplus assets.

While these figures are no doubt large in absolute terms, I think it is important to understand their comparison to the total defined benefit universe to put them in proper perspective. Since 1980, including all pending cases, they total less than 1 percent of all defined benefit plans, approximately 2.6 percent of all participants in defined benefit plans, and only approximately 6 percent of all accumulated surplus assets in existing defined benefit pension plans.

I think that these statistics show that in light of the overall pension universe, that reversions are clearly the exception, rather than the rule. In any event, this sharp increase in activity in large terminations since 1982 attracted the attention of the Government agencies that are charged with the responsibility of enforcing current law as passed by the Congress. In this regard, the ERISA agencies representing the Department of the Treasury, the Internal Revenue Service, the Department of Labor and the Pension Benefit Guaranty Corporation conducted an extensive review of current and proposed termination transactions within the context of current law.

This extensive review quickly uncovered some potential abuses within the context of current law based on certain proposed novel termination transactions and the ERISA agencies promptly set out to seek administrative solutions within the context of ERISA. These potential abuses included the proposed use of the spin-off termination transaction by some plan sponsors in an attempt to avoid giving notice to participants, avoid fully vesting them in their accrued benefit, avoid purchasing annuities for the full value of their accrued benefit and avoid allocating excess assets to any employee contributions. We deemed this a clear abuse of current law.

Second, they addressed the use of unreasonable interest rates for the purposes of valuing lump-sum valuations in alternative distribution forms.

Third, they addressed the potential for repeated transactions by plan sponsors in any attempt to fund on a termination basis or use these as corporate piggybanks.

Fourth, they provided appropriate safeguards as to future plan funding and the PBGC insurance system.

These guidelines were announced in March 1984 by Robert A.G. Monks, who was then the Labor Department's Pension Administrator for the Office of Pension and Welfare Benefit Programs.

On May 23, 1984, the ERISA agencies released a joint interagency press release on the implementation guidelines. These guidelines represent an informal summary of the principles of current law relative to reversions. The purpose of the press release was to dispell considerable confusion in the private pension community concerning where the Government stood and which transactions would be challenged under current law.

In summary, the guidelines dealt with all identified abuses that the ERISA agencies were able to identify within the context of current law, including making it clear that an employer must provide a fair value for all benefits accrued before obtaining a reversion.

The guidelines also provided safeguards regarding future funding and against repeated transactions.

Finally, and very importantly, I think, they serve to clarify that an employer can maintain a defined benefit plan for its workers after receiving a reversion, thus, encouraging the maintenance of defined benefit pension plans for active employees. In this regard, I think that we now have some history to judge what their effect has been.

There has been a dramatic increase in the relative percentage of participants that are now being covered in successor-defined benefit plans since the guidelines have been promulgated as compared to what practice had been for plan sponsors prior to that point in time. Specifically, prior to the announcement of the guidelines, only 23 percent of all participants in plans being terminated involving reversions were being covered in successor-defined benefit plans. However, since the guidelines have been announced, some 70 percent of all participants are now being covered in successor-defined benefit plans which we feel is a great accomplishment and something that should be noted.

Since the guidelines have been promulgated, there has been no doubt some debate with regard to their legal basis. I think it is important to note that the guidelines reflects the ERISA agencies' interpretation of current law and are not novel legal principles.

Despite this fact, as members of the committee are undoubtedly aware, there is a company that is proposing to engage in an unadjusted "spin-off termination" transaction who desires to receive a reversion without complying with the guidelines and the rules provided by title IV. This company, in effect, is arguing that the guidelines are inappropriate and too stringent. Specifically, they argue that a company should be able, through a paper division of a pension plan into two separate entities, to take part on all of the plan's surplus assets while depriving most participants of the protections mandated by ERISA.

In the opinion of the PBGC, this is a clear abuse and the plaintiff's position in this case goes beyond what current law contemplates and would take away many of the important protections that the Congress deemed appropriate when it passed ERISA in 1974. We are, therefore, vigorously pursuing this matter and I am confident that the PBGC will prevail in this litigation.

Mr. Chairman, I should now like to briefly address if I could some of the specific concerns that have been raised by the previous witnesses and some of other commentators with regard to asset reversions.

While some statistical analysis has been done as to the impact of reversions on participants, I think it is important to note that many of these have been theoretical in nature. As previously noted, an overwhelming majority of large sponsors who are terminating these plans and obtaining reversions are providing successor-defined benefit plans for their active employees which provide the same or, in many cases, improved benefit structures from the prior plan in order to sell the concept to employees. In addition, the overwhelming majority are providing for full prior-service credit.

Finally, as a result of the guidelines, many participants are actually vested in benefits that they otherwise might not ever receive as a result of the requirements of the guidelines. In fact, I think that many of the complaints about reversions are somewhat misdirected in that they really represent complaints about the exodus of employers from the defined benefit system. We share the concerns of Congress to avoid any action which might adversely impact the willingness of a plan sponsor to create, maintain or adequately fund defined benefit plans since they clearly represent a preferable form of retirement income for the American worker.

In this regard, it is important to understand that departures from the defined benefit system are not caused by the reversion. The decision as to what type of successor plan to establish is a separate and distinct matter and, in fact, by observing the principles that are laid down in the administration guidelines, an employer can continue to cover their active employees in a successor plan after obtaining a reversion.

As I previously mentioned in this regard, there has been a dramatic and significant increase in the percentage of participants so covered in successor-defined benefit plans subsequent to the announcement of the guidelines.

It should also be noted that the decision of a plan sponsor not to set up a successor-defined benefit plan is generally the result of financial hardship or other factors totally unrelated to reversions. While plan sponsors are not mandated by law to provide the PBGC with their reasons for termination, many voluntarily do so as part of their notice of intent to terminate.

Some have also complained that reversions deny participants the opportunity to participate in future ad hoc cost-of-living increases, especially with regard to retirees. It is important to note that in the case of active employees who are covered in a successor-defined benefit plan, a comparable one, there is no loss whatsoever in expected benefits to the extent that prior-service credit is given and the overwhelming majority of plan sponsors do so.

In addition, the fact that an employer has received a reversion does not prevent it from making voluntary cost-of-living adjustments for retirees. The decision to increase retirees' benefits based upon our experience, depends primarily upon the employer's financial health and its overall relationship with retired employees. It should also be noted that if the plan provides for COLA's they must be provided for in the annuity purchase before the company can obtain a reversion.

Concerns have also been expressed with regard to some of the employers' uses of these surplus assets; however, it is important to note that the ERISA agencies have no jurisdiction with regard to the use of surplus funds. It should be noted, though, that in some cases, reversions have been used for purposes such as to avoid layoffs or even perhaps bankruptcy, to finance expansion, which could have created jobs, to reduce debt loads contracted during the recession and to otherwise help American enterprises to meet the great challenges they now face. This is not to say that reversions are good, because I can assure you, Mr. Chairman, that this administration has no desire whatsoever to encourage reversions.

Regarding legislative proposals, I cannot comment today on specific legislative proposals or address specific legislative aspects of the reversion issue. The administration will formulate its position on specific bills, including H.R. 2901, through the normal legislative process. However, I can say that in evaluating any proposed legislative changes, the administration's central concern, in addition to fully protecting the participants, will be to recognize that the private pension system in this country is a voluntary one—it has worked well—and that an employer is and should be free to establish or terminate a plan so long as it meets the benefit obligations that it promises and it does not manipulate the timing of the termination so as to improperly shed liabilities on the insurance system or otherwise abuse the related parties.

Again, Mr. Chairman, let me assure you that the administration has no desire whatsoever to encourage reversions. At the same time, the administration believes that any proposal that would serve to significantly reduce or effectively eliminate the ability of plan sponsors to obtain bona fide reversions would be counterproductive. Specifically, the likely price would be an unwillingness on behalf of employers to establish, maintain, or properly fund existing plans generously or to grant benefit increases. The long-run effect would thus be very harmful to the interests of retirees, employees, and the companies for which they work.

Mr. Chairman, this summarizes my overview comments and I would be happy to respond to any questions that you or other committee members may have in this regard.

[The prepared statement of Mr. Walker follows:]

PREPARED STATEMENT OF DAVID M. WALKER, ACTING EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Messrs. Chairmen, I am pleased to appear before you today to present a statement on behalf of the Administration concerning reversions of surplus pension plan assets to employers under the Employee Retirement Income Security Act of 1974.

I feel it is important to briefly discuss the related provisions of current law and the trend in reversion activity as a prelude to my discussion of the Administration guidelines.

The Congress decided, in passing ERISA in 1974, that one key to better protecting the benefits promised to participants in defined benefit plans was to encourage better and more responsible funding of these plans. Thus, ERISA requires employers to contribute sufficient assets to their plans to meet statutory minimum funding standards. If, however, contributions and their accumulated plan experience prove to be greater than needed to provide all benefits, section 4044(d) of ERISA explicitly allows the plan sponsor to reclaim any surplus assets that exist if and only if the plan is terminated and cretain conditions are met.

In the first several years of ERISA's existence, substantial reversions of surplus assets occurred infrequently, primarily because chronically depressed stock and bond markets made it difficult for plans to accumulate large surpluses of assets relative to their benefit obligations. In more recent years, however, things have changed. Since August 1982, there has been a significant increase in the number and magnitude of terminations resulting in reversions to the plan sponsor. Three factors are primarily responsible:

1. A significant rise in the equity market since August 1982 has dramatically increased pension plan assets.
2. The cost of purchasing annuities as a means of satisfying plan liabilities has significantly decreased, because the annuity rates currently available are abnormally high (compared to plan funding and inflation rates).
3. The corporate and financial communities have become more aware of the importance and materiality of pension plan transactions.

EXTENT OF REVERSIONS OF SURPLUS ASSETS

While the subject of asset reversions is no doubt a complex and controversial matter, I feel it is important to put total reversion activity in perspective.

Between January 1980 and May 31, 1985, the PBGC issued Notices of Sufficiency to 508 terminated plans with asset reversions in excess of $1 million for a total of $4.9 billion. Another 221 cases were pending as of May 31, 1985, involving $1.8 billion in surplus assets. Although these figures are large in absolute terms, reversions since 1980 total only about one percent of aggregate plan assets and no more than six percent of the estimated aggregate surplus assets held by all defined benefit plans. In addition, the plans from which large reversions have been recovered represent less than one percent of total plans and only 2.6 percent of all defined benefit pension plan participants. These statistics show that, when viewed in light of the overall pension universe, reversions are the exception rather than the rule.

ADMINISTRATION GUIDELINES

While the total reversion activity is a peripheral phenomenon to the total universe, the sharp increase in the number of large reversions since 1982 attracted the attention of the government agencies that deal with penson matters—the Department of Labor, the Internal Revenue Service and the Pension Benefit Guaranty Corporation. The ERISA agencies quickly discovered that some potential abuses existed within the context of certain proposed termination transactions and promptly set about to seek administrative solutions within the framework of ERISA.

Substantive discussions among the agencies began in July 1983. Because the issues involved were novel and complex, some time was needed to sort them out. By March 1984 the agencies had arrived at a common legal and policy position, which was announced at Senate Committee hearings on April 4, 1984, by Robert A.G. Monks, than the Labor Department's penson administrator. On May 23, 1984, the agencies released the joint "implementation guidelines", via a joint inter-agency press release. These guidelines represent an informal summary of the principles of current law applicable to reversions. The purpose of these guidelines was to dispel the considerable confusion in the private pension community concerning where the government stood and what transactions could be safely undertaken without the risk of legal challenge.

In the course of their discussions, the ERISA agencies identified three principal abuses associated with reversions. They also determined that each of these problems could and should be dealt with in the context of present law and without amending ERISA in ways that might discourage the establishment or adequate funding of defined benefit pension plans.

First, some transactions leading to reversions were designed in such a way as to circumvent the protective requirements of ERISA. For example, Title IV and the accompanying PBGC regulations require terminated plans to fully vest all participants in their accrued benefit and purchase annuities to provide these benefits, unless the value of the benefit is de minimis or the participant consents to an alternative form of distribution. In addition, the minimum funding rules require that plans be funded on a "going concern", rather than termination, basis. Thus, these rules generally require that an employer currently fund some portion of projected future benefits. The purpose of these requirements is to ensure that all promised benefits are actually paid, regardless of what may happen in future financial markets.

In some instances, the agencies found, plan sponsors tried to maximize their reversions by attempting not to vest or purchase annuities for some plan participants. In addition, some sponsors were attempting to avoid allocating excess assets attributable to employee contributions. The guidelines dealt with these problems by pointing out that the annuitization of all benefits accrued to the date of termination and allocation of excess assets attributable to employee contributions is mandatory under ERISA and PBGC regulations. This requirement cannot be avoided by dividing a plan artificially just before termination so as to exclude some group of employees from the protections of Title IV. In addition, in order to insure that the likely future funding will be adequate to provide future benefit accruals, the guidelines require that the amortization period for future funding be decreased in certain situations.

Second, ERISA and PBGC regulations require that, in those instances where participants receive alternatives to annuity distributions, such as lump sums, reasonable interest rates be used to calculate the value of the alternative distribution. In one much publicized case—which is still in litigation—a terminated plan cashed out participants' benefits using market rates for group annities that were much higher than market rates reasonably available to individuals. The higher interest rates, of course, produced lower distributions to participants, since they are used to discount rather than enhance the benefits value.

The guidelines noted that this abuse would be stopped through a rewriting of the pertinent PBGC regulation. A new regulation has been drafted by the PBGC and should be published within the next several weeks. In the meantime, the PBGC embarked upon a vigorous administrative program of reviewing the interest rates used to value alternative benefit forms in cases where a plan sponsor was to receive a reversion. I am pleased to say that we have received virtually unanimous cooperation from employers in this effort and that, since May 1984, there have been no instances in which the rates used for valuing alternative forms differed substantially from those that will be required by the forthcoming regulation.

Third, before the issuance of the guidelines, there was great confusion in the private sector about whether a company that had received a reversion could continue defined benefit plan coverage for its employees. In some instances, the decision was to "play safe" by replacing a terminated defined benefit plan with some other type of retirement program, such as a profit sharing plan or an employee stock ownership plan. This potential exodus from the defined benefit system greatly concerned the ERISA agencies.

The guidelines made it clear an employer must provide a fair value for all accrued benefits before obtaining a reversion. In addition, they clarify that an employer can maintain a defined benefit plan for its workers after receiving a reversion. The effect of this clarification on plan sponsor decisions regarding replacement plans for active employees has been striking.

CONTINUED PENSION COVERAGE FOR MOST PARTICIPANTS

Since the Administration issued its reversion guidelines, the percentage of active participants covered under successor defined benefit plans has surged dramatically, from about 23 percent before the guidelines to about 70 percent thereafter.

As of May 31, 1985, about 87 percent of all active participants in the pending reversion cases over $1 million are covered under successor plans sponsored by the same or a new employer. That number may be even higher because plans are not required to notify the PBGC whether participants in a terminated plan will continue some pension coverage under a new or existing plan. Our analysis indicates that, of those participants we know are covered by successor plans, 71 percent are covered under defined benefit plans, and 29 percent under defined contribution plans.

Plan sponsors that did not establish successor plans often lacked the financial wherewithal to do so. About 13 percent of the pending reversion cases over $1 million not reestablishing plans for their active employees cited adverse business conditions, closing of the employing unit, dissolution of the employer or bankruptcy as the primary reason for termination.

GUIDELINES' IMPACT IN OTHER AREAS

Besides the critical protections offered participants, the guidelines, by reaffirming a plan sponsor's right to terminate a defined benefit pension plan and obtain a lawful reversion of surplus assets, ensure that employers will not intentionally underfund their plans in order to avoid accumulating any surplus assets in the plan. The guidelines also encourage the establishment of successor defined benefit plans and limit the potential risk to plan participants and the PBGC where a new plan is established.

LEGAL BASIS FOR THE GUIDELINES

Since the guidelines have been promulgated, there has been some debate regarding their legal basis. Those guidelines reflect the ERISA agencies' interpretation of current law.

ERISA declares that an employer may recover surplus assets from a defined benefit pension plan when the plan is terminated. It does not say that, once a company has terminated a plan, it may never again extend defined benefit coverage to its employees. Nor is there any conceivable reason why the law should say such a thing. Defined benefit plans have long played a central role in U.S. retirement policy and ought to be fostered, not discouraged.

The problem that faced the drafters of the guidelines was how to distinguish bona fide terminations from transactions that simply withdrew assets from an ongoing plan. Our basis in fashioning an answer was to look at what the law requires terminated plans to do. When a purportedly terminated plan does those things, it is reasonable—indeed, legally obligatory—to treat it as terminated. When, on the other hand, a company constructs a transaction that has the form of a termination but lacks substance, it is reasonable and essential to maintain that no termination has in fact occurred, and no plan assets can revert to the employer.

Let us look at how these principles apply to termination-reestablishment and spinoff-termination transactions. In the former, the plan is terminated in full accordance with the requirements of Title IV of ERISA, and a new plan—usually a mirror image—replaces it. In this case, the terminated plan, like any other plan that terminates under Title IV, must give participants advance notice of the termination, allocate its assets in accordance with Section 4044 of ERISA (which, in an overfunded plan, automatically results in full vesting of all accrued benefits) and purchase annuities to provide all accrued benefits, except for benefits of de minimis value and those that participants agree to receive in a different form. Compliance with these requirements significantly changes the relationship among the plan, the employer and the plan participants. Hence, it would be difficult to attack a termination-reestablishment on the ground that the substantive requirements for termination had not been complied with. So far as we can determine, such transactions, though rare before 1982, occurred from time to time before and after the enactment of ERISA without legal challenge from the ERISA agencies.

Spinoff-terminations raise more complex issues. Some companies have attempted to use these transactions to recover surplus assets while evading compliance with Title IV. The guidelines in effect say that substance is more important than form. If, in a spinoff-termination, the plan does all those things that would be required if it were terminated and then reestablished, the transaction will be treated as "essentially equivalent" to a termination-reestablishment and will be immune to challenge for the same reasons. If, on the other hand, the plan sponsor is unwilling to satisfy the requirements of Title IV of ERISA, it cannot take advantage of Title IV in order to gain a reversion.

As the members of the committees are probably aware, a company that would like to engage in a spinoff-termination and receive a reversion without complying with rules of Title IV has brought suit against the PBGC. This company has argued, in effect, that a company should be able, through a paper division of a pension plan into two allegedly separate plans, to take all of the plan's surplus assets while depriving most participants of the protections mandated by ERISA. The PBGC believes, however, that the plaintiffs' position in this case goes beyond what the law contemplates and would take away the important protections embodied in the Title IV termination rules. They in effect are arguing that the guidelines are inappropriate and too stringent. I am confident that the PBGC will prevail in this litigation.

SPECIFIC CONCERNS REGARDING REVERSIONS

I should now like to take note of some specific concerns that have been raised, both by the previous witnesses today and by other commentators.

While some statistical analysis has been done on the impact of reversions on participants, these studies have generally been theoretical in nature. As previously noted, a significant majority of large employers establish successor defined benefit plans for their active employees that provide the same or improved benefit structures and full credit for past service. Finally, as a result of the guidelines, some participants are vested in benefits they otherwise might not have received.

In fact, many of the complaints about reversions are misdirected. They are really complaints about the exit of employers from the defined benefit plan system. A defined benefit plan is generally a better retirement arrangement, from the worker's point of view, than an alternative such as a profit sharing plan or an employee stock ownership plan. It is important to understand that departures from the defined benefit system are not caused by the reversion. The decision as to what type of successor plan to establish is a separate and distinct matter. By observing the principles laid down in the reversion guidelines, however, an employer can continue defined benefit coverage for its employees after receiving a reversion.

Our statistical analysis shows that the guidelines have served to significantly increase the percentage of participants covered in successor defined benefit plans. It should also be noted that the decision of a plan sponsor not to set up a successor defined benefit plan is generally the result of financial hardship or other factors unrelated to reversions.

Some have complained that reversions deny participants the opportunity to participate in future ad hoc cost-of-living increases. This is not the case for active employees who are covered in an identical successor plan. In addition, the fact that an employer has received a reversion does not prevent it from making voluntary cost-of-living adjustments for retirees. The decision to increase retirees' benefits depends upon the employer's financial health and its overall relationship with its retired employees.

Concerns have also been expressed regarding some employers' use of surplus pension assets, however, the ERISA agencies have no jurisdiction in this area beyond that required to assure compliance with the law when a plan terminates. However, it should also be noted that reversions have been used to avoid layoffs or perhaps even bankruptcy, to finance expansion, to reduce debt loads contracted during the recession and otherwise to enable American enterprises to meet the great challenges that they now face.

LEGISLATIVE PROPOSALS

I cannot comment today on specific legislative proposals that address various aspects of the reversion issue. The Administration will formulate its position on specific bills through the normal legislative process. However, in evaluating any suggested legislative change, the Administration's central concern will be to recognize that the private pension system is a voluntary one. An employer is and should be free to establish or terminate a plan, so long as it meets its benefit commitments and does not manipulate the timing of the termination to shed liabilities improperly on the insurance system.

The Administration has no desire to encourage reversions. At the same time, the Administration believes that any proposal that would serve to significantly reduce or affectively eliminate the ability of sponsors to obtain bona fide reversions would be counter-productive. The likely price would be unwillingness on the part of employers to establish new pension plans, to fund existing plans generously or to grants benefit increases. The long-run effect would thus be harmful to the interests of retirees, employees and the companies for which they work.

Thank you for the opportunity to testify on this important issue. I will be happy to answer any questions you and the Committee members might have.

Mr. **Roybal**. Thank you very much, Mr. Walker. Your testimony is most interesting, particularly in view of the fact that your position differs from facts presented to this committee over the period of the last 2 years. You have testified that terminations have resulted in improved benefit plans granting full credit to the retiree.

Now, during the time that we have had hearings on this subject matter, we haven't received a single letter from a single retiree that tells the committee that they are better off under the new plan; nor have we been able to get a single person to testify that they are better off now than they were before the termination.

Looking at this subject matter from what has actually happened, you base your entire testimony on the presumption that restricting asset reversions would cause employers to underfund their plans or cease using defined benefit plans at all. For those two facts that you have presented, facts insofar as you are concerned, what empirical evidence do you have to support this hypothesis or is it merely speculation?

Mr. **Walker**. Mr. Chairman, there is no question that there are many factors that have an impact on a company's determination as to, first, whether to establish a plan; or second, what type of plan to establish.

I think that one can say that there is absolutely no question that to the extent that legislation might be proposed that would significantly increase the risk or the cost to the employer in an unreasonable manner thereby tipping the scales against them, then by doing so, unquestionably would have an adverse impact on their willingness to create or maintain defined-benefit plans. The exact magnitude of such activity, I will grant, is difficult to ascertain. However, I would like to point to what sponsors did before and after the guidelines with regard to making these decisions as to successor plans. As an illustration. Before the guidelines were announced, there was an overwhelming tendency of sponsors who wanted to obtain the reversion to leave the defined benefit system due to their concerns over any undue restorations by the Government. However, once the guidelines were announced, thereby clearing the air of uncertainty, sponsors have switched to a strong preference to maintain successor defined-benefit plans. Therefore, I think you can say that any significantly increased cost or restrictions will have an adverse impact.

Mr. ROYBAL. But what about the fact that this committee has received no testimony, nor have we received any letters in favor of your decision or statement with regard to the fact that all of this had resulted in improved benefit plans and with full credit to the retiree? That is very difficult for anyone to understand, particularly since this committee, we believe, is responding to a national need.

Now, can you provide this committee with either empirical facts, statistics or even names of individuals who may be willing to come before this committee and tell us how well off they are now? Can you do that, Mr. Walker?

Mr. WALKER. Mr. Chairman, let me clarify my point in that regard if I can. First, plan sponsors are not required to inform us as to whether or not the benefit structure has been improved. We have—we do become aware in individual cases as to whether or not this is the case.

We can say with certainty that in the case of a "spinoff termination" transaction which, in that case, you are dealing with exactly the same plan that existed prior to the termination, the exactly same terms as after, which includes——

Mr. ROYBAL. Yes, but how did you finally come to the conclusion that they are better off; that they have improved their benefit plans; and that they have received full credit? What facts do you have that finally made you come to that conclusion? You must have something.

Mr. WALKER. Mr. Chairman, my testimony, I believe, is that they have the same, or in some cases, improved benefit structures. As a point of clarification, in the case of a "spinoff termination" transaction and "termination reestablishment" transaction, you are dealing with either the same plan or substantially the same plan with full prior-service credit, with the same benefit entitlement provisions and with the same benefit accrual provisions. In addition, we are aware of some plan sponsors (for example AMAX and Celenese) who actually improved their benefit formulas. Others undoubtedly exist. In any event—out of the 911 cases that are pending before the PBGC at this point in time, as of May 31, 1985, 71 percent represented those types of transactions.

By definition, we found that they aren't any worse off. They may be better in some cases, but they are not any worse. Let me also add that in the case of complying with the guidelines, one of the requirements is that a sponsor must fully vest all participants and purchase a third-party annuity contract for the full value of these accrued benefits, and this insulates the participants from the future risk of adverse investment performance that might otherwise have occurred in an ongoing situation.

So I am not saying they are all good by any means, Mr. Chairman. On the other hand, I am saying they are not all bad, either.

Mr. **Roybal**. All right. Now, there is obviously a difference of opinion, and before I yield my time, which is up, to Mr. Saxton, I would like to ask you just one question. Would you favor a moratorium on this whole subject matter while you or your organization conducts a study in conjunction with this committee? I will just leave the question right there. Would you favor such a moratorium?

Mr. **Walker**. I am not in a position, Mr. Chairman, to state a position on behalf of the administration, which is basically what——

Mr. **Roybal**. But what is your personal opinion, Mr. Walker? Do you think we need more study with regard to this problem?

Mr. **Walker**. Mr. Chairman, quite candidly, I think that we have statistical data that has been exchanged——

Mr. **Roybal**. I asked you for statistical data just a little while ago. You weren't able to produce it on two very important subjects. If you have the statistical data, please present it to this committee.

Mr. **Walker**. Mr. Chairman, it is my understanding that all requests for statistical data that have come to us at this point in time have been provided.

Mr. **Roybal**. It probably hasn't been very clear or not very effective because it doesn't answer the question.

Mr. **Walker**. I would be more than happy to review any outstanding requests or any additional requests that the chairman may have——

Mr. **Roybal**. All right. Now, in the event that whatever you have submitted is not sufficient, would you then agree to a moratorium until such time as both your agency and our committee conducts a study?

Mr. **Walker**. I am not in a position to take a position on that at this point in time, Mr. Chairman.

Mr. **Roybal**. All right, Mr. Saxton.

Mr. **Saxton**. Thank you, Mr. Chairman.

When Senator Metzenbaum was here this morning and opened the session, I believe you were here. The Senator indicated that what he saw as the primary problem was that as people who are employed by employers who terminate programs are affected, basically the primary effect is down the road in future cost-of-living adjustments as they receive their benefits. Do you see that as the major problem as well?

Mr. **Walker**. That is one of the recurring concerns that we have heard expressed, but I think it is important to note, as has been noted previously, that COLA's aren't mandated under current law, whether it be with regard to termination or with regard to an ongoing plan. In addition, if a plan provides for a COLA then the sponsor must include it in the annuity purchase before they can obtain a reversion. However, clearly, that is one of the main concerns to the extent that you are dealing with expected benefits, as opposed to promised benefits.

Mr. Saxton. May I back up to—you used a number of 71 percent a few minutes ago in response to one of the chairman's questions. Could you clarify what you were talking about exactly with 71 percent or——

Mr. Walker. I would be happy to.

Of the approximate 221 plans that were pending at the PBGC as of May 31, 1985, approximately 71 percent of all participants affected by those terminations will be covered in a successor-defined benefit plan after the termination.

Mr. Saxton. Are you saying that they will be covered by a plan that is equal to or better than the one that was terminated?

Mr. Walker. The overwhelming majority will be covered by a plan that is equal to, identically the same, or better than. I don't have the exact numbers of ones that may not be, but I can clearly tell you that of the 221, I could probably count them on one hand, probably with fingers left over, but we don't have that exact figure. Again, they are not required to give us information as to future benefits, so it is difficult for me to say with certainty.

Mr. Saxton. Can you explain in any way why we haven't heard testimony to that effect today? I would love to give you the benefit of the doubt and say that is great, but we have not heard testimony, nor have we been able to receive information to that effect from anyone else. I am curious if you can explain, maybe, why that is.

Mr. Walker. I can possibly clarify one case which has been the subject of testimony today. If I am not mistaken, I believe that the Celanese transaction, which was one of the people that testified today, was, in fact, a spinoff termination transaction and if such is the case, it means that by definition, that the plan is probably exactly the same after the event as it was before, including full credit for prior service. In fact, I believe Celanese actually increased benefits under the successor plan. So that would be an example.

I think that no doubt these are complex, controversial, emotional, and difficult issues. They don't lend themselves to a natural positive response in behalf of participants no matter how they are actually affected. I think a point that you made before, Congressman, is true. When you look at reversions, you have to try to deal with the abuses, which is what we do, and on the other hand, not go too far to where you, in effect, you kill the goose that laid the golden egg, namely, the successful voluntary private pension system.

Mr. Saxton. During the day, we have noted that companies terminate defined benefit plans for a variety of reasons including satisfaction of debts and takeover problems and solvency problems or simply to reinvest for the benefit of the company. Of the 500 companies which have terminated defined benefit programs, do you have a breakdown as to why they did?

Mr. Walker. I don't have it available to me here today, but I could provide it for the record as to the reasons they may have informed as per the notice of intent to terminate. I must footnote by saying that they are not required to inform us, but for the ones that did, I will be more than happy to provide that for the record.

Mr. Saxton. We would appreciate it if you could provide that information for us.

[See appendix VI, for the information provided by Mr. Walker.]

Mr. **SAXTON**. One final question. For the benefit of the committee, could you describe the current administration process involved when a company indicates it wishes to terminate its plan?

Mr. **WALKER**. When a company indicates it wishes to terminate the plan, it is required by law to file a notice of intent to terminate with the Pension Benefit Guaranty Corporation and also notify the Internal Revenue Service. They must also give notification to all participants of the termination and the proposed transaction.

We then review that proposed notice of intent to terminate, along with a wealth of information that is submitted, including proposed benefit calculations, and the purchase of an annuity contract from a qualified insurer to provide those benefits. We review to make sure that they are complying with the guidelines to the extent they are applicable. We review to be sure that they are using reasonable interest rates for the valuing of lump sums. In summary, we review to ensure full enforcement of all provisions of current law, including the guidelines.

To the extent that after we have reviewed all of this information, we are satisfied that they are in compliance with current law, including the guidelines, we will issue a notice of sufficiency which authorizes distribution of assets, including annuity contracts. I might add that to the extent that the plan is a contributory plan—by that, I mean that the employees contributed in the plan as well as the employer, by law they receive a portion of the excess assets.

We review the proposed allocation for that once plan is closed out in the private sector we have no further responsibilities. That is with regard to reversion plans.

Mr. **SAXTON**. On an average roughly, how long does the process take?

Mr. **WALKER**. The statute provides us 90 days, but in many cases, due to the many issues that have to be reviewed and the data that we have to obtain and our cautious review of these—we are very concerned about them—many times either the company or we will request extensions. Therefore, the average time, I would say, would be 9 months.

Mr. **SAXTON**. Have any applications or requests been turned down?

Mr. **WALKER**. Yes. One example is the case which I referred to in my testimony where we are in litigation. We refused to recognize the validity of that transaction because they did not fully comply with the administration's guidelines. We will continue to refuse to recognize any transaction that did not comply with the guidelines.

Mr. **SAXTON**. Thank you.

Mr. **ROYBAL**. Thank you, Mr. Saxton.

Mr. Clay.

Mr. **CLAY**. Thank you, Mr. Chairman.

Mr. Walker, following up on that one refusal, they sued you, didn't they?

Mr. **WALKER**. That is correct, but before they sued us, we returned their notice of intent to terminate and informed them that their proposed transaction did not represent a termination since it was not in accordance with the administration guidelines.

Mr. Clay. That gets me to my question: What will the administration do if its guidelines are struck down in court?

Mr. Walker. First, I don't expect that to happen; and second, if it does, we will have to deal with that circumstance and determine the appropriate course of actions at that time.

Mr. Clay. I bet you are the only one in the country that does not expect that to happen, and you don't even have a contingent plan?

Mr. Walker. We have a great General Counsel's Office, Mr. Chairman. I am confident that we will prevail in the case.

Mr. Clay. They wrote those guidelines which exceed the law. I am sure that case is going to be overturned, but I am not an attorney.

Mr. Walker. I am not, either.

Mr. Clay. Let me ask you this. I am having a problem following your logic. You say that the change in the law for overfunded plans would be counterproductive, but your predecessor, Mr. Ed Jones, came to Congress asking on behalf of this administration for premium increases and to change the law for underfunded plans.

Now, wouldn't the same argument apply with respect to increased costs to employers when the plan is underfunded? Why is that not a disincentive for us to change the law for underfunded plans and it is a disincentive for us to change the law for overfunded plans?

Mr. Walker. There is absolutely no question that PBGC premiums have some impact on a plan sponsor's willingness to create or maintain a defined benefit plan. However, the reason that I do not believe that it should have a significant impact because of the relative immateriality of the amounts involved when considered in the aggregate. I think it is important to note that even at our new proposed premium level, which is $7.50, PBGE premium will represent less than 1 percent of annual pension costs to a plan. So, therefore, I do not believe that such an increase would have a material adverse impact on plans.

On the other hand, in overfunded plans, you are dealing with much larger sums and, depending upon the legislation that is being proposed, it may potentially have a significant increase in the cost of the ability of a plan's sponsor to access some of these funds in appropriate situations.

Mr. Clay. Let me ask you the same question I have asked everybody else. To whom do you believe that these funds belong?

Mr. Walker. Under current law, other than excess assets attributable to employee contributions, I believe that it is clear that they belong to the employer, provided that they meet the requirements that are expressly set out in section 4044 of ERISA. I think it is important to note that in a defined benefit plan, the promise is the benefit and that the employer assumes all risk of investment performance, whether it be good or bad, in meeting that promise. I think that is the prevailing aspect.

Mr. Clay. The Treasury tax plan proposes to tax health benefits, but no real distinction can be made between the contributions for health benefits and for retirement benefits. If one is considered deferred income, therefore taxable to the employee, the other, I would think, would also have to be considered deferred income.

If so, do those who should pay taxes on these amounts own the assets of those plans?

Mr. **Walker**. First, let me say, Congressman, that I think to the extent that you are asking me to respond to a Treasury Department——

Mr. **Clay**. We have got Treasury people here——

Mr. **Walker**. Yes, I think it would be appropriate that they do that.

If I could, I would also note, though, Congressman, that the Treasury proposal also proposes an excise tax on reversions of 10 percent, which——

Mr. **Clay**. But I understand you oppose that. Is that correct? Your agency opposed it, is that correct?

Mr. **Walker**. Our prior executive director expressed concern, which I think was valid, that such a proposal might serve to encourage a rush to the door for terminations and, in effect, questioned the basis for it or the effective impact of it.

Mr. **Clay**. So you did oppose it?

Mr. **Walker**. The agency didn't take a formal position on the matter.

Mr. **Clay**. Do you support it now?

Mr. **Walker**. It is the administration's proposal——

Mr. **Clay**. Do you support it now?

Mr. **Walker**. We support what the President sends to the Hill.

Mr. **Clay**. All right, if Treasury can tell me the difference between wages deferred for health benefits and wages deferred for pension benefits, I would like to hear that distinction.

Mr. **Conaway**. Mr. Clay, I am Harry Conaway, with the Treasury Department.

As I understand your question, there are arrangements through which employers may provide deferred health benefits, in effect. They are commonly known as voluntary employee beneficiary associations, BEBA's. The BEBA rule specifically provide that a reversion is not available to the employer. That is not the case in defined benefit program.

Mr. **Clay**. Why should it be any different for pensions?

Mr. **Conaway**. The question I think that we have addressed is the current law question as to——

Mr. **Clay**. We are talking about a proposal to change the law and I want your opinion. Why should it be different for pensions than it is for health benefits?

Mr. **Conaway**. I think there is a good argument that the rules should be parallel in the two areas. The question really is, though, whether the defined benefit rules should be changed or whether the medical rules should be changed. I think there is an argument that perhaps the rules applicable to the funding, the advance funding of BEBA's for future medical benefits are, in a sense, discourage the maintenance of those plans and sufficient levels of funding for the——

Mr. **Clay**. Can you tell me the difference between the two funds? I mean, health benefit funds and pension benefit funds? Tell me the difference.

I can't understand how you could say one is a deferred income and either be silent on the other or say it is something other than deferred income. If health benefits are deferred income, therefore, that is the rationale for taxing them. Wouldn't pension benefits be the same?

Mr. **Conaway**. I am not certain that I understand your point about taxing.

Mr. **Clay**. The point I am making is, I am trying to find out who owns the funds in the pension fund. Now, if you are going to tax the health benefits—and I see no difference because what you are alleging is that these are deferred wages. If they are deferred wages, the wage-earner, I would think, owns them.

If pension benefits are deferred wages, I would think that the workers would own that fund, and not the company that is cashing the pension plan out for the excess amount of money in it.

Mr. **Conaway**. I think in each case, in the case of a BEBA for future medical benefits, and in the case of the defined benefit plan, the arrangements are essentially funding vehicles for the employer to deliver the promised future benefits.

I think under that analysis, the argument would be that the rules on the BEBA side should be altered. If you want to make them parallel, I agree with you, as a general matter, you would want parallel rules in the two areas where there is advanced funding.

I don't know that the tax treatment of the employees when they receive medical benefits, when they receive pension benefits, is an important factor to consider in determining whose funds—who owns the funds in the BEBA or the plan, but——

Mr. **Clay**. I am just trying to keep this administration honest in their definitions.

Thank you, Mr. Chairman.

Mr. **Roybal**. Thank you, Mr. Chairman.

I would like to thank Mr. Walker and Mr. Conaway for their testimony this afternoon. Mr. Walker, I am chairman of the Committee on Aging, as you know. I am also chairman of the Subcommittee on Treasury, which comes under the Committee on Appropriations. It is my plan to send you a letter as chairman of both committees asking that you respond, or asking you to join us in a 9-month moratorium in order to give your agency an opportunity to conduct a study on the effects of terminations and a comparison of the new and old plans.

That response will be made a part of the record of this hearing.

I say that because I think it is most important that we clearly get the position of the agency with regard to a study. We know for a fact, as you have testified, that a formal study has not been made up to this point and if that is a fact, then we need more information and I think that both you and I would like to have that information in order to be just and effective as we legislate on this subject matter.

I assume that legislation is needed and so does every member of this committee. We would like to have some confirmation on that, but before a final move is made, we would like to get as much information from experts like yourself and other experts that testified today who, incidentally, did not agree with you, but who testified in an effort to reach some conclusions.

I would like to, therefore, thank you, Mr. Walker and Mr. Conaway, for very excellent testimony and thank also all of those who testified today. It has been a most rewarding hearing. We hope that you didn't get too tired waiting to testify, but this is the way hearings go sometimes, and we have to make the best of it.

Thanks again for being present.

Mr. **Walker**. Thank you, Mr. Chairman.

Mr. **Roybal**. The meeting is adjourned.

[Whereupon, at 2 p.m., the hearing was adjourned.]

APPENDIX I

BRIEFING MATERIALS ON PLAN TERMINATIONS AND ASSET REVERSIONS TO EMPLOYERS

JUNE 12, 1985

House Select Committee on Aging

Edward R. Roybal
Chairman

I. Introduction

II. Background

III. Termination Data

IV. Legislative and Regulatory History

V. Conclusion

Appendix

A. Agency Correspondence
B. Agency Background Memoranda
C. Plan Termination Lists
D. Other Information

BECAUSE OF THE LENGTH OF THESE MATERIALS, MEMBERS ARE URGED TO CARRY THESE MATERIALS TO THE HEARING.

A pension plan in its simplest terms is a legal promise by an employer to pay a periodic benefit (usually for the life of the retiree) to an employee who meets the requirements set forth in the plan. An employee in a defined benefit pension plan anticipates and believes that he or she will receive a specified (determinable or defined) benefit after working the required number of years for the employer prior to retirement. The financial security of these workers and their families are wholly dependent on the legal promise of that employer and the federal laws which seek to assure retirement security (the Employee Retirement Security Act of 1974-ERISA and the Internal Revenue Code of 1954-the CODE).

I. INTRODUCTION:

It is the purpose of this joint hearing to examine those issues and problems arising out of the trend of overfunded defined benefit pension plan terminations which have occurred over the last five years. To date, approximately 600 overfunded defined benefit pension plans have been terminated wherein in each sponsoring employer received a reversion of at least $1 million. Presently, approximately 200 applications for overfunded terminations of at least $1 million are pending at the Pension Benefit Guaranty Corporation. In aggregate terms, plan sponsors have recovered since 1979 to the present approximately $4 billion in asset reversions following overfunded terminations. Another $2 billion in potential reversions is presently pending. Over 700,000 workers have had their pension benefits affected through these overfunded terminations and roughly 300,000 more will have their benefits affected under pending termination requests. While these figures in the aggregate seem large, they represent only a small percentage of total assets and workers covered under our Nation's defined benefit pension system. However, the loss of retirement security to workers and retirees from such terminations is real and the potential threats to other workers, the defined benefit pension system and the federal government and its policy supporting secure and definable retirement benefits is squarely posed by this continuing trend of overfunded terminations.

This hearing is an attempt to explore a number of issues and problems associated with overfunded pension plan terminations. The hearing will attempt to focus on (1) whether the trend of overfunded defined benefit pension plan terminations presents retirement security problems for workers and retirees with respect to their anticipated retirement security, (2) whether overfunded plan terminations undermine the federal pension policy to promote permanent programs of secure and definable retirement benefits for workers, (3) whether the Administration's "Implementation Guidelines" on overfunded terminations and plan asset reversions is statutorily supportable and an effective policy to address those various problems arising from overfunded terminations, and (4) whether a legislative solution to the problems of overfunded terminations is presently needed.

Why would a company drop a pension plan? It's done for the money. Employers are terminating their pension funds to recover so-called "excess" assets. These are amounts which remain after all liabilities (benefits to workers) have been satisfied after the termination of the pension plan by the employer. These excess assets however, are not really excess at all but rather represent benefits which would otherwise be paid to workers but for the premature termination of the plan by the employer. Large numbers of pension plans are temporarily overfunded today, because the value of their investments is up, interest rates are up and employment is static. A number of companies now find themselves with more assets in their pension plans than are needed to pay vested benefits. The only way they can recapture the excess assets quickly is to terminate the plan. Companies are generally not allowed to borrow the surplus from their pension plans. But the Employee Retirement Income Security Act of 1974 (ERISA) the federal law which regulates private pension and welfare benefit plans does not prohibit employers from terminating the plan and taking the surplus assets for their own.

In overfunded plan terminations, both employees and retirees may lose valuable retirement benefits they will need to make their retirement financially secure. For example, a 15-year employee of XYZ Corp. who plans to retire in 10 years may reasonably expect to receive pension benefits of $550 a month on retirement, as defined in the pension plan. However, as a result of the termination of the corporation's "overfunded" pension plan, the employee might receive a benefit of only $300 a month. Even if a new plan were initiated, it might treat this worker as a "new" employee, so benefits would not accrue fast enough to provide anything like the pension anticipated under the old plan. Similarly, a retiree who might anticipate an ad hoc cost of living increase from his employer will, after an overfunded termination, typically not receive such a cost of living increase because the excess assets that would otherwise fund the increase will now be taken by the employer.

A Department of Labor study on overfunded terminations concluded that the difference to workers between an expected real benefit and a terminated nominal benefit, where there is no replacement plan, could represent approximately 45% of the real expected benefit. Also, under a number of different termination scenerios, workers age 45 through 65 will lose a substantial portion of their expected retirement benefit due to an overfunded plan termination because of the loss of accruals at these later ages under certain funding methods. Thus, the termination of an "overfunded" plan can have a devastating impact on the retirement security of a worker and his family. Moreover, retiree's would lose cost-of-living adjustments because such adjustments typically are provided through the plan's excess assets, money that will now go to the employer on termination of the plan.

Several legislative proposals to address the issues involved in overfunded terminations have been made. These proposals include (1) the so called "loan or actuarial" loss approach (2) the "business necessity" approach embodied in the Plan Termination and Reversion Control Act of 1985, (3) the approach adopted by Senator Metzenbaum in his amendment (to S-1227) in the 98th Congress which provides an adjusted cost of living increase to participants after an overfunded termination, and (4) the approach permitting spinoff and reestablishment terminations under the Administration "Implementation Guidelines". A synopsis of these four approachs are included with these materials.

Due to the complexity of the issues involved in this area, a brief overview of the approach taken by the Administration and a brief history of the issues involved in the termination trend have been provided below.

II. BACKGROUND

Federal regulatory efforts have done little to impede or resist the rising tide of overfunded plan terminations which deprive workers of needed pension benefits. In less than five years employer pension terminations have netted approximately $4 billion for corporations. While the Administration in May, 1984 issued "Implementation Guidelines" on plan terminations and asset reversions, fully 4 1/2 years of increasing termination activity had occurred prior to their issuance. Moreover, hearings held by the Select Committee on Aging in June of 1982 and September of 1983 involving the Administration representatives from the Department of Labor, the Internal Revenue Service and the Pension Benefit Guaranty Corporation had graphically demonstrated the scope and severity of the problems associated with the growing number of overfunded terminations and their impact on employees and retirees. **In 1979 there were ten overfunded plan terminations totalling $18 million, in 1980 there were 8 totalling $19 million in 1981 there were 34 totalling $175 million in 1982 there were 81 $570 million and in 1983 there were 151 totalling $2.1 billion.**

The House Select Committee on Aging has previously conducted two hearings regarding instances where workers have lost potential retirement benefits through overfunded terminations. The first hearing, on June 7, 1982 reviewed the situation of the termination of the Harper and Row Publishers Pension Plan and its subsequent replacement by an Employee Stock Ownership Plan that was instituted by the management of that publisher. Present and former employees of Harper and Row testified at that time that the termination of the Harper and Row plan resulted in a loss of their retirement security and resulted in significant losses of benefits due to the inordinately high 15% interest rate which was applied to lump sum distributions to many of the workers.

A second hearing held on September 28, 1983 indicated the continuing problems associated with overfunded terminations generally and examined the status of federal law as viewed by the Department of Labor and the Internal Revenue Service on overfunded terminations. The Department of Labor testified that the decision of a plan sponsor to terminate a plan is a business decision and not a fiduciary decision covered by ERISA. It should be noted that this position of the Department of Labor was subsequently supported by a decision of the federal district court involving Harper and Row Publishers v. District 65 which sought to apply the fiduciary provisions of ERISA to the decision to terminate an overfunded pension plan. The Internal Revenue Service testified that, generally, the various requirements of the Internal Revenue Code permitted the return of surplus assets after the satisfaction of all accrued benefits to participants and beneficiaries at the termination of the plan. Moreover, the Service indicated that those amounts which arose as a result of "erroneous actuarial error" were recoverable by employers under the Service's regulations. Finally, the Service testified that it was concerned about the then new possible arrangements for terminations involving so-called "spinoff terminations" and termination "reestablishment" cases.

Since that testimony by the Department of Labor and Internal Revenue Service to this Committee, Mr. Robert A. G. Monks, former pension administrator for the Department of Labor on April 4, 1984 before the Senate Labor Subcommittee, announced a new Administration position ("Implementation Guidelines") regarding overfunded terminations. This new position provides that employers may engage in spinoff and termination reestablishment terminations. A spinoff termination involves the termination of an overfunded pension plan in which the surplus and retired participants are retained in the former plan while a new and substantially comparable successor plan is created for active participants. The former plan is then terminated so that the employer may recover any excess assets. In a termination reestablishment case, the plan, which is overfunded, is terminated by the employer to recover the excess assets and a new and substantially comparable defined benefit plan is instituted to replace the former plan. Both of these methods of terminating and subsequently substituting a substantially comparable successor plan have been permitted under the Administration's implementation guidelines.

The Administration guidelines require that upon the termination of the plan, all participants and beneficiaries must be fully vested in their accrued benefits and that annuity contracts must be purchased for these individuals. Noticeably absent from these guidelines however, is any requirement to mandate that past service credits from the previous plan be credited to the successor plan for participants. While there is some argument that annuitization of vested credits provides some inflation protection for those vested benefits, clearly with respect to those plans in which the salary factor plays a principle role in determining benefits (final pay plans), the absence of any requirement to pick up past service credit in a successor plan will result, in some degree, in a diminuition in benefits that would have otherwise been realized under the previous defined benefit plan. To this degree, and more starkly, the absence of mandated past service credits in a successor plan may well invite a reduction in absolute terms of projected benefits that could have been earned under the previous plan. Moreover, for a less altruistic employer, the absence of mandated past service credit may represent an open invitation to diminish benefits in any successor plan that might be instituted by the employer.

A group of tax attorneys who had petitioned the Internal Revenue Service and the Pension Benefit Guaranty Corporation to utilize the spinoff method of termination, had provided in their submission to the agencies that a "cushion" of excess assets be carried into the successor plan, ostensibly to protect against a shortfall in funding in early years and to provide some modicum of protection to the Pension Benefit Guaranty Corporation in its responsibility to the successor plan. However, the Administration did not include a requirement for a cushion within its guidelines. Rather, after some review, it was apparently felt that the annuitization of accrued benefits and the minimum funding standards would be sufficient to protect future benefit accruals and provide sufficient insulation to the Corporation with respect to the successor plan. It is problematic however, that the annuitization and minimum funding standards will provide sufficient protection particularly for the Corporation in the event that a termination of a successor plan occurs in years shortly after the creation of the successor plan. Moreover, it is also reasonable to assume that at any point at which interest rates and other market conditions decline and affect the actuarial liabilities of the plan, that the Administration's guidelines will not provide a sufficient buffer to insure an adequate and solvent funding of the plan under those circumstances, particularly within the early years of the successor plan's creation.

One problem noted in previous Committee hearings and recognized as an issue within the Administration guidelines has been the use of inordinately high interest rates applied to lump-sum distributions made to participants upon termination. Testimony by one witness before the Committee indicated that based upon his twelve years of service with Harper and Row Publishers he had received a lump-sum distribution of approximately $700 for his accrued benefit. Upon seeking a life annuity from an insurance carrier however, he received a quote of approximately $7,000 to secure such an annuity. The Administration has responded to this abuse by promulgating a regulation that requires an interest rate be used which approximates a market or annuity rate. While the new rate set by the Corporation will more closely align with prevailing market interest rates, such a formulation however, still falls short of the most accurate barometer of accrued benefits, the use of an annuity interest rate to determine lump-sum amounts.

The use of the spinoff and termination reestablishment techniques and certain other requirements which are embodied in the Administration guidelines raise significant questions regarding the authority under ERISA and the Code to permit such arrangements. One threshold problem involves an apparent lack of authority under the Code and Title IV of ERISA to prescribe the conditions attending a spinoff and termination reestablishment under the guidelines. The use of the spinoff and termination restablishment techniques directly undermine the minimum funding standards prescribed under Titles I and II of ERISA. No exception or limitation is provided within those provisions to permit a redefinition or reorientation of the specific requirements of funding in the manner constrained through spinoff and reestablishment terminations. Moreover, there appears to be little or no authority within the fabric of Title IV upon which the Corporation could authorize the use of these techniques. The requirement that a plan sponsor could not engage in another termination and subsequent reestablishment of a defined benefit plan within a fifteen year period is not specifically prescribed in either the Code or Title IV of ERISA, but rather it appears to be based on the fifteen year requirement to amoritize experience gains. Basically, the Administration guidelines in this area simply undercut the policy and requirements of minimum funding under ERISA making null and void the need to preserve reserves of funding to protect participants, plan sponsors and the Corporation. The policy of the guidelines in this area simply cede to the employer any surplus through plan termination with little or no recognition of the policy objectives and requirements respecting minimum funding.

In recent correspondence between the Select Committee and the Department of Treasury (see Appendix), it has become clear that the Administration views the "Guidelines" as merely a statement of enforcement policy rather than a substantive set of rules controlling plan asset reversions upon termination. Such a view makes clear that the guidelines need not be observed by a court and, in fact, the guidelines are presently being challenged in the courts by two plan sponsors, Celanese Corporation and Interco Inc., who contend that certain specific requirements of the Guidelines lack an appropriate statutory basis. These contentions by plan sponsors mirror closely the previously enunciated concerns of Chairman Roybal in correspondence to the Treasury Department and the Pension Benefit Guaranty Corporation. The outcome of these pending lawsuits may well portend the demise of an enforcement strategy which held little statutory credence.

A significant area without guidance in the guidelines involves tax policy and the opportunity for tax abuse through overfunded terminations. The Committee on Aging has written extensively to the Service inquiring whether, in their opinion, opportunities for tax abuse exist within the present structure of overfunded terminations which have occurred to date. The responses of the Service had largely been unedifying on this topic until recently. What is clear is that an employer through the recapture of excess assets has received a windfall through tax deductions for contributions and exemptions for interest and dividends realized on plan assets. This preferred tax treatment is accorded to encourage the establishment and presumed maintenance of permanent programs of pension benefits to provide retirement income security to workers covered under these programs. An employer who is recapturing excess assets is reaping a significant tax benefit even assuming the reversion is included as income to the employer. An employer in a position to offset any tax liability with respect to the reversion through tax loss carryforwards may significantly defray or entirely eliminate any tax liability that would otherwise result from the reversion (For example, A&P Stores was acquired by a West German conglamorate for $200 million, received a reversion upon the termination of the A&P pension plan in excess of $200 million, thus entirely writing-off the cost of acquisition and than used tax loss carry forwards to eliminate any tax liability.) Such a result can be analogized to other abusive tax treatments of investments which have been the concern of both the Administration and the Service in other areas. Simply, some employers may have treated their tax qualified pension plans as merely a "tax free corporate savings device". In its most recent revised tax plan, the Department of Treasury is seeking the imposition of a 10% excise tax on any asset reversion arising out of a plan termination. This position was taken by the Treasury Department only to recover the time cost of money of the favorable tax treatment rather than as a disincentive to overfunded terminations. (See Treasury II tax plan and supporting statements.)

Perhaps the single greatest failure of the Administration guidelines is that they fail to address the basic concern implicit in overfunded terminations. That is, that as a matter of public policy the failure to in any way inhibit or control overfunded terminations serves to erode the basic federal policy supporting the establishment and maintenance of pension plans, which is to provide a secure reservoir of monies to provide retirement income to workers.

III. TERMINATION DATA

Recent data derived from the Pension Benefit Guaranty Corporation (PBGC) indicate that, after the issuance of the Administration Guidelines in May of 1984, the number of overfunded defined benefit plan terminations has substantially increased. PBGC data indicate that an estimated 279 plans, each with over $1 million in excess assets reverting to the employer, were to be terminated in 1984. This number of terminations is comparable to the total of all such terminations, 284, for the previous 5 years (1979-1983). It is also noteable that the total of excess assets to be reverted to employers for 1984 is expected to exceed $3 billion, this compared with $2.14 billion for the period of 1979 through 1983. The data also indicates that the average reversion to the employer has substantially increased. For example, in 1980, the average reversion from an individual plan was approximately $2.1 million. By 1984, this figure had grown to approximately $11.3 million per terminated plan. (See Appendix)

The majority of these terminations have been taken not because of an apparent financial necessity of that employer but, rather, because the employer desired to obtain a reversion to accomplish some business purpose which might include preventing or sponsoring a takeover, improving the financial statements of that employer, or using the reversion to finance the acquisition of employer stock. While some commentators may believe that the use of a reversion in this manner is not an appropriate subject for review in the context of setting policy on employee pension plans, it would seem imperative that such a review is incumbent, at this point, to ensure that appropriate safeguards are provided to assure employee benefit security. Presently, there are pending applications for overfunded terminations (involving reversions of $1 million or more) which are rapidly approaching $1 billion. The issuance of Administration guidelines, which sanction the use of spinoff and termination reestablishment techniques, would seem to provide a fertile environment to encourage further overfunded terminations. Moreover, the convenience of the termination vehicles available within the Administration guidelines provide an easier mechanism to accomplish a plan asset reversion than those methods previously sanctioned by the Agencies.

IV. LEGISLATIVE AND REGULATORY HISTORY

ERISA was passed to correct a number of pension asset abuses which were prevalent at the time. It was designed to establish fiduciary dutires to govern the use of pension plan assets, as well as to insure that defined benefit plans would be adequately funded.

The legislative history of ERISA would seem to indicate that Congress considered the assets of defined benefit plans to be the deferred wages of employees. Thus, Senator Harrision Williams one of the principle architects of ERISA stressed in floor debate "that pensions are not gratuities. They represent savings which the worker has earned in the form of deferred payment for his labors." (floor debate, 9-18-73, pg. 1605). Senator Jacob Javits reiterated this conclusion:

> The fact of the matter is that the private pension plan is a means for transferring earnings during the working years into income for a decent living in the older years. The worker "works" for that pension the same way he "works" for his wages or salary... (floor debate, 9-18-73, pg. 1609)

Title IV of ERISA provides for the reversion of assets to the plan sponsor upon plan termination. Section 4044(d)(1) of ERISA states:

> Any residual assets of a single employer plan may be distributed to the employer if -
>
> (A) all liabilities of the plan to participants and their beneficiaries have been satisfied,
>
> (B) the distribution does not contravene any provision of law, and
>
> (C) the plan provides for such a distribution in these circumstances.

Section 4044(d)(1) of ERISA permits a defined benefit plan sponsor to recover excess plan assets on plan termination if (1) all liabilities of the plan to participants and their beneficiaries have been satisfied, (2) the distribution would not "contravene any provision of law", and (3) the plan provies for a reversion in such circumstances. However, Section 4044(d)(2) limits reversions in the case of contributory plans by requiring excess assets attributable to employee contributions to be "equitably distributed to employees who made such contributions (or their beneficiaries) in accordance with their rate of contributions."

Reversions that meet the requirements of Section 4044(d)(1) and (2) are excepted from the ERISA provision requiring that plan assets never inure to the benefit of any employer and that they be held for the exclusive purposes of providing benefits to plan participants and beneficiaries and for defraying reasonable plan administrative expenses. See ERISA Section 403(c)(1). In addition, the reversion rules of Section 4044 apply to the termination of pension plans to which the Title IV coverage provisions are inapplicable "except as otherwise provided in regulations of the Secretary (of Labor)." See ERISA Section 403(d)(1). Finally, ERISA Section 404 makes the general rules pertaining to fiduciary duties subject ot he exceptions and specific rules covering reversions previously specified, and ERISA Section 408(b)(9) exempts from the prohibited transaction provisions reversions that satisfy Section 4044.

It is quite clear from the foregoing that ERISA generally permits a defined-benefit plan sponsor to recapture excess plan assets on plan termination. However, in the wake of the public reaction against the recent wave of asset reversions, questions have been raised concerning the degree to which Congress fully debated or understood the policy behind Section 4044.

In the development of ERISA, there was one instance in which a so called "abusive" termination occurred prior to enactment. This involved the Elgin Watch Case wherein the company had not contributed to their pension plan since 1958 because the plan was discovered to be overfunded. Further contributions might have jeopardized their tax qualified status. The Elgin Watch Plan was a contributory plan which held at that time a surplus of approximately $12 million which the company proposed to recapture by terminating the plan in 1971-72. Employees covered by the plan believe that some or part of the surplus belonged to them. Then Senator Stevenson proposed amendments that would have required that all surpluses be distributed to plan participants. However, this position was ultimately rejected apparently because it was felt that the long standing policy under the Internal Revenue Code to permit recapture of surplus assets by an employer should not be changed. Then S-4 the precursor to ERISA, then contained provisions which now appear as Section 4044(d)(2) of ERISA.

Also,the provisions of the Internal Revenue Code apply to the termination of an overfunded pension . Specifically, section 401(a)(2) of the Code states that a plan will fail to be tax qualified unless, under the trust instrument, it is impossible, before the satisfaction of all liabilities to participants and beneficiaries, for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. With respect to the satisfaction of liabilities, IRS regulation 26 CFR 1.401-2(B)(1) recognizes that residual assets resulting from "actuarial error" can revert to the employer upon termination:

> The intent and purpose in section 401(a)(2) of the phrase "prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust" is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, any balance remaining in the trust which is due to erroneous actuarial computations during the previous life of the trust. A balance due to an "erroneous actuarial computation" is the surplus arising because actual requirements differ from the expected requirements even though the latter were based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan and were made by a person competent to make such determinations in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding.

The regulation goes on to state that such "actuarial errors" result when the plan's experience differs from the reasonable interest rate, mortality, etc. assumptions made in order to administer the plan on a sound basis. Acceptable reversions are then distinguished from impermissible reversions composed of excess assets resulting from changes in the plan's benefit provisions or eligibility rules. Thus, the mere fact of a reversion will not alone cause a plan to be disqualified upon termination.

On April 4, 1984 the Administration announced the issuance of "Implementation Guidelines" concerning overfunded pension plan terminations. Specifically, these guidelines address the use of two termination techniques, spinoff and reestablishment terminations. Under the guidelines an employer may terminate an overfunded plan through spinning off active employees into a new comparable successor pension plan, retaining retirees and surplus assets in the old plan and then terminating the old plan to recover excess assets. The guidelines require that annuity contracts must be purchased for active employees and retirees, much like a true termination. In a termination reestablishment, the employer wholly terminates the overfunded defined benefit plan and then subsequently creates a new and comparable defined benefit plan covering the same workforce. The guidelines note that both spinoff and reestablishment transactions would be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the conditions of the guidelines are satisfied. Again, these principle conditions are the purchase of annuities, faster amortization (i.e. faster funding) under the successor plan, vesting of all participants including non-vested participants and that an employer may not engage in a similar transaction any earlier than 15 years from the preceding transaction.

Substantial questions have been raised as to whether the conditions contained in the guidelines are, in fact, grounded in specific statutory authority under ERISA Title IV and the Code. Presently, there are two pending lawsuits against the Guidelines. One is by the Celanese Corporation for declaratory judgement in the U. S. tax court concerning its spinoff termination. Specifically, court papers indicate that Celanese challenges the authority of the guidelines to require faster funding in the successor plan, indicating that authority to impose such a requirement is not contained in Section 412 of the Code. Interco Corporation has brought suit in federal district court in St. Louis challenging the basic authority of the Agencies to impose the conditions contained in the guidelines. Specifically, Interco contends in court papers that the Agencies have defectively attempted to issue regulations which violate the APA requirements for notice and comment for regulations. In addition, Interco indicates that if the guidelines are not regulations, they are merely a statement of enforcement policy which is not binding on a federal court. Moreover, Interco contends that the authority of the PBGC is limited to merely performing the "ministerial" act of providing a sufficiency notice to a sufficient overfunded plan and that the PBGC has no authority under Title IV to impose any conditions as provided in the guidelines. Correspondence from Assistant Treasury Secretary Pearlman to Chairman Roybal of the Aging Committee discloses that in their view, the guidelines represent "a statement of enforcement policy" and are not regulations with the force and effect of law.

Some commentators have expressed concern that the minimum funding requirements of Title I of ERISA and the Code are essentially undermined by the sanctioning and use of spinoff and reestablishment techniques permitted by the guidelines. However, the Internal Revenue Service has previously granted qualified tax status to reestablish plans prior to the issuance of the guidelines.

V. CONCLUSION

As noted earlier, there are several purposes which are being approached in context of this hearing. One purpose is to examine the continuing trend of overfunded defined benefit pension plan terminations and to seek to determine whether and to what extent plan participants and retirees may be harmed by such terminations. A second purpose is to determine whether these terminations represent a potential threat to the defined benefit pension system and to the Pension Benefit Guaranty Corporation, the federal corporation which provides plan termination insurance for employees covered by insufficient plans. A third area of concern is whether the use of certain termination techniques (i.e. spinoff and reestablishment terminations) are adviseable as a matter of federal policy and whether such techniques, sanctioned by the Implementation Guidelines, are in fact supported by present law. A fourth consideration is whether legislative attention in the form of remedial legislation is now needed to protect workers, retirees and their families and whether there should be the formation of a new federal pension policy which protects these individuals from the affects of overfunded pension plan terminations.

Please find attached pertinent correspondence from the Agencies to the Select Committee on Aging, background memoranda from the Agencies on plan terminations and asset reversions, list of pending and terminated plans and other pertinent data.

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MINORITY STAFF DIRECTOR

A-1

November 3, 1983

The Honorable Raymond J. Donovan
Secretary
U.S. Department of Labor
200 Constitution Avenue
Washington, D.C.

Dear Mr. Secretary:

As you are aware, on September 28, 1983, Mr. Allan Lebowitz, the Acting Administrator of Pension and Welfare Benefit Programs of the Department of Labor, testified at a public hearing of the House Select Committee on Aging (the committee) concerning pension asset "raids." In brief, Mr. Lebowitz testified that the decision of a plan sponsor to terminate a defined benefit pension plan with the intention of causing a reversion of excess assets to the sponsor was not a fiduciary one under the Employee Retirement Income Security Act of 1974 (ERISA) and that "the Department does not believe that employers should be prevented from terminating the plans they sponsor as long as the benefits earned by participants and beneficiaries are protected."

I have reviewed this testimony and that of Mr. Charles Williamson, Assistant Administrator for Enforcement, Pension and Welfare Benefit Programs, who testified in connection with the Harper & Row case that he had asked the Solicitor of Labor for "their best opinion as to whether there was a violation" because he was concerned that there might have "been a scheme to manipulate plan assets for purposes that were not solely in the interest of plan participants," including "prudence violations in regard to the profit-sharing plan." I have concluded that the Department of Labor's position with regard to terminations that involve reversions of excess assets is deficient in terms of both current law and with respect to the potential need for additional legislation. I am therefore requesting that you review personally the testimony presented by your subordinates on these issues in order to determine whether the Department's views require further clarification and/or modification.

First of all, I am dismayed by the Department's reluctance to come squarely to grips with concerns previously expressed by myself and the Committee over these matters. By drawing a sharp distinction between actions taken with regard to ongoing plans and those taken with regard to terminated ones, the Department has created the impression that actions by corporate officials that it would not countenance under ERISA in the case of ongoing plans are legitimate and tolerable in the case of terminated plans. It should be apparent that if such a distinction is maintained, it will constitute an open invitation to plan sponsors or their officials to use terminations as a device to circumvent ERISA's fiduciary standards whenever it is convenient for them to do so.

I take strong exception to this mechanical approach to the problems of plan termination abuse and apparently so also do a number of respected editorialists and other writers in the field whose views I am enclosing with this letter for your further consideration. Moreover, you should know that the Pension Benefit Guaranty Corporation (PBGC) has furnished data to this committee that indicates that since 1980, 104 U.S. companies have recaptured in excess of $443 million from the termination of 114 defined benefit pension plans. However, these figures exclude a number of major terminations that are pending or in litigation, and if these were added it is estimated that total reversions to plan sponsors would reach approximately $1.2 billion. See *Pension & Investment Age,* August 22, 1983.

Proposed terminations disclosed after this article was published have raised the committee's projected total of plan asset reversions to something in excess of $1.7 billion. Surely this unprecedented wave of defined benefit plan terminations, which involve a number of major corporations in this country, and were designed for no other apparent purpose than to enable plan sponsors or their officials to strip long-established and well-financed plans of so-called "surplus" assets, deserves something more than the unfocused response the Department has made to date.

I am also confused as to the basis for some of the Department's thinking in cases like Harper & Row. For example, Mr. Lebowitz testified that under ERISA, excess assets may properly revert to a plan sponsor so long as their distribution does not contravene "any provision of law," apparently referring to ERISA section 4044 (d) (1) (B). However, he appeared to interpret that phraseology as limited to ERISA and the Internal Revenue Code rules on distribution. Other witnesses testified that the phraseology was not so restricted but required a determination as to whether other principles of law besides those embodied in ERISA and the Internal Revenue Code may also be violated by a reversionary distribution to the sponsor. Specific reference was made to the preamble to the PBGC's regulations on Allocation of Residual Assets, 29 CFR § 2618.30 (46 FR 49845), October 8, 1981, which reads as follows:

> Section 2618.30 provides that residual assets that are not attributable to employee contributions may revert to the employer if the plan provides for reversion and the distribution does not violate any provision of law. This provision reflects the language in section 4044 (d) (1) of the Act. One comment noted that the phrase "the distribution does not violate any provision of law" is too restrictive and disregards judicial elucidation and equity. It was suggested that the regulation require that "the distribution does not violate law or equity" and that "a good faith determination to terminate has been made under the fiduciary standards" of the Act. PBGC

> believes that the regulation should not, and need not, go beyond the statutory language. The allocation process is separate from any judicial remedies based on equity or violations of the fiduciary standards of the Act. Moreover, PBGC believes that "provision of law" includes judicial interpretation of written laws and does not preclude a court from exercising its equitable powers. PBGC further notes that the provisions on fiduciary responsibility and the enforcement of fiduciary responsibilities are found in Title I of the Act and are not within PBGC's jurisdiction. (emphasis added)

It is clear from the foregoing that PBGC has interpreted section 4044 (d) (1) (B) as manifesting a Congressional intent to require a determination of whether (among other things) a reversionary distribution would violate judicially articulated equitable principles, and it would be proper for the agency charged with enforcing the fiduciary provisions of Title I, i.e., the Department of Labor, to make such a determination in connection with possible violations of ERISA section 403 (c) (1), which forbids the inurement of plan assets for the benefit of any employer except as provided under ERISA sections 4042 and 4044.

Not only is Mr. Lebowitz's testimony inconsistent with the views expressed by PBGC in the preamble to its final regulations; it further appears that in its investigation of the Harper & Row case, the Department of Labor made no legal determination of whether the reversion of excess assets would violate generally accepted equitable principles or whether, in Mr. Williamson's words, the termination and reversion of excess assets was part of a "scheme to manipulate plan assets for purposes not solely in the interest of plan participants." In short, the Department has apparently given a highly restrictive and dubious reading to key language in ERISA in order to justify a policy of inaction with respect to this issue.

The Department's restrictive approach is even more baffling when considered together with testimony presented by the Internal Revenue Service (IRS) and other witnesses which indicated that the IRS was aware of "abuse situations" where the termination of a defined-benefit plan, accompanied by the employer's establishment of a new defined benefit plan for active but not retired participants, was followed by a reversion of excess assets from the terminated plan to the employer. These so called "spin-off" terminations are now being studied by the IRS to determine whether they can be blocked under current law as being "gimmicks" rather than authentic terminations.

Let me observe that the Department of Labor seems to be conspicuously absent from these discussions in terms of its own responsibility to enforce ERISA section 403 (c) (1). Of more consequence, however, is the possibility that if IRS moves successfully to thwart "spin-off" terminations, this will lead to an even greater use of Harper & Row type terminations (i.e., where a defined benefit plan is replaced by an employee stock ownership plan instead of another defined benefit plan in order to facilitate the recapture of excess assets) unless the Department of Labor, PBGC and the IRS act together on both types of terminations. It would be inexcusable if uncoordinated agency policies artifically encouraged rather than discouraged a greater abandonment of defined benefit pension plans. Indeed, it is my understanding that this has already happened in one so-called "spin-off" case involving a Stroh Brewery plan, where the sponsor has withdrawn its request for approval of the "spin-off" termination and instead determined to abandon the defined benefit plan entirely as a means of recapturing surplus assets. See Pension and Investment Age, October 31, 1983.

In light of these developments, the Department has a clear obligation to reexamine its overall position on terminations together with the IRS and PBGC. The abbreviated, mechanistic approval procedures used by IRS and PBGC are wholly inadequate to insure that plan terminations conform with ERISA's fiduciary requirements. It is therefore imperative that the Department develop a coordinated enforcement policy in conjunction with these other agencies. Unfortunately, I find the Department's testimony in connection with its investigation of the Harper & Row case, for example, unsatisfactory in a number of major respects. A complete explanation is required with respect to the following:

1. Why did the Department not request the IRS to hold up its approval of the new Harper & Row employee stock ownership plan, pending completion of its own investigation into the circumstances surrounding the termination of the Harper & Row defined benefit pension plan and the use of the profit-sharing plan assets to purchase controlling shares of stock in Harper & Row, in view of Mr. Williamson's testimony that the ERISA enforcement division of the Department suspected there might have been a "scheme to manipulate plan assets for purposes that were not solely in the interest of plan participants"?

2. If Irving Trust, the trustee of the Harper & Row profit-sharing plan, resigned in October, 1981, because it believed that the profit-sharing plan's purchase of Harper & Row common stock held by the Minneapolis Star and Tribune created a serious conflict of interest subject to legal challenge under ERISA, did Irving Trust have the duty to prevent a possible breach of trust by informing the Department of Labor or seeking assistance in court?

3. Harper & Row defended the propriety of amending its profit-sharing plan to require it to purchase the Minneapolis Star and Tribune stock by asserting that, among other things, it relied on an opinion of a purportedly independent investment advisor, Kidder Peabody & Co., Inc. By letter of September 14, 1983, (copy enclosed) the Department rejected an application from the Harcourt, Brace, Jovanovich, Inc. Pension Plan for relief from the prohibited transaction provisions of ERISA so that Harcourt Brace could use its pension plan assets to buy land in Florida on which an office building would be built for the benefit and use of the company and leased to the company. The principal reason why the Department rejected the Harcourt Brace request was the Department's determination that Kidder Peabody & Co., Inc. had not; in fact, performed its professed role as an "interim independent fiduciary" in evaluating the fairness of the proposed sale-leaseback transaction. Based on materials forwarded to this Committee, it does not appear that the Department sought to determine in its

investigation of Harper & Row whether, in fact, Kidder Peabody provided independent advice to Harper & Row in connection with the latter's use of profit-sharing plan assets. The Committee would like a full explanation of the reasons for the Department's failure to make such an inquiry.

4. Under ERISA, do fiduciaries of a pension plan have a duty to inquire into the circumstances under which a plan sponsor terminates the plan in order to determine whether the decision to terminate was lawful? For example, to determine whether the decision to terminate was brought about as a result of the exercise of undue influence or fraud? If so, do the fiduciaries also have the duty under the doctrine of the Bierwirth case to seek independent advice on this matter if the corporate officials responsibile for the decision to terminate the plan are also the plan's fiduciaries? If the duty of inquiry is required under ERISA, including the duty to obtain independent advice, was it fulfilled in the Harper & Row case?

5. Under ERISA, do plan fiduciaries have a duty to resist the implementation of a plans sponsor's decision to terminate the plan if the plan fiduciaries ascertain that the decision to terminate was brought about, for example, by the exercise of undue influence or fraud? If so, in potential takeover cases, where officials of a corporate sponsor cause the plan to be terminated in order to use excess plan assets to buy controlling shares of stock in the sponsor in order to prevent a takeover, do the plan's fiduciaries have the duty to resist the termination on grounds that the termination was the result of the undue influence of the sponsor's officials who were seeking to entrench themselves? Where any of these issues considered by the Department in conducting its investigation of the Harper & Row case, assuming the Department regards them as relevant under ERISA?

6. If a corporate sponsor makes false and misleading statements to obtain its shareholders' approval of the sponsor's decision to terminate a defined benefit pension plan, do such misrepresentations affect the sponsor's right to a reversion of excess assets under ERISA section 4044 (d) (1)? If so, did the Department investigate this issue in connection with reversion of excess assets in the Harper & Row case?

7. Is it a violation of ERISA if a corporate sponsor's board of directors usurps functions expressly reserved to plan fiduciaries in the event of plan termination? For example, if on termination the plan requires the plan's fiduciaries to allocate and distribute the terminated plan's assets to participants and beneficiaries by selecting an appropriate lump sum method of distribution or by the purchase of an annuity contract and, contrary to the plan's provisions, the board of directors rather than the fiduciaries makes and implements these decisions, has ERISA been violated? If so, did the Department's investigation in the Harper & Row case determine whether such a violation had occurred?

8. Mr. Williamson testified that the determination of the reasonableness of the 15% interest assumption used to calculate the value of lump sum benefits payable to the participants of the terminated Harper & Row defined-benefit plan was not a function of the Department but rather of PBGC and that PBGC had approved the interest assumption used in the Harper & Row case. However, do plan fiduciaries have a duty of loyalty to assure that the calculation of lump sum benefits is based on an interest assumption that would be most

favorable to the participants in the plan rather than most favorable to the plan's sponsor? That is, assuming, for the sake of argument, that a range of interest assumptions have been generally approved by PBGC for use, do plan fiduciaries nonetheless have a duty to select that assumption within the approved range which would most nearly result in approximation of the true present value that participants have been led to expect they would receive? If so, was such a course followed by the plan fiduciaries in Harper & Row, and if not, did the plan fiduciaries violate their duty of exclusive loyalty?

In addition, did the Department investigate to determine whether (a) the PBGC and IRS were properly notified by the plan fiduciaries that a 15% interest rate assumption would be actually used to determine lump sum benefits, and (b) were PBGC and IRS actually aware that such an assumption would be used to calculate lump sum benefits at the time these agencies approved the termination? If the answer to the foregoing questions is negative, does the Department have the responsibility to bring these matters to the attention of the respective agencies involved and request reconsideration of their actions in connection with approving the termination?

The Committee and I believe that the answers to these questions as well as a complete reexamination of the Department's investigation of the Harper & Row case should be pursued in light of the conflicting testimony that was presented at the hearing. I ask for an expeditious reply to this letter.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

cc: Alan Lebowitz
Robert Eccles

sd

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of:

A-2

MAR 29 [illegible]

Honorable Edward R. Roybal
Chairman, Select Committee on Aging
House of Representatives
712 House Annex #1
300 New Jersey Avenue, S.E.
Washington, D.C. 20515

Dear Mr. Chairman:

I am pleased to respond to your letter of November 3 to the Secretary and November 4 to Acting Administrator Alan Lebowitz in which you raised a series of questions as a follow-up to the topics discussed at the Committee's hearing on September 28. We regret the delay in responding.

For purposes of simplicity, the answers follow the order of the questions presented in the November 4 letter, but are intended to address both sets of inquiries. Cross-references from the November 3 letter are as follows:

1. Please see answers to questions 13 and 22 below as to the Department's views on the effect of an IRS determination letter on a Department of Labor investigation.

2. As to the duties of plan fiduciaries who obtain knowledge of breaches of trust, please see the answer to question 19 below.

3. Please see the answer to the last portion of question 22 below.

4. Please see the answers to questions 24 and 25 below.

5. Please see the answer to question 26 below.

6. Please see the answer to question 26 below.

7. Please see answer to question 28 below. The Departments' investigation relating to Harper and Row encompassed this area, and a decision was made not to bring litigation.

8. Please see the answers to questions 20 and 29 below.

Following are the answers to the November 4 letter.

1. Nothing in ERISA requires an employer to establish a defined benefit pension plan.

2. Sections 402 and 403 establish structural and functional standards for employee benefit plans and trusts and their officials. Section 404 establishes standards for fiduciaries to follow in carrying out their duties.

3. Section 403(c)(1) sets forth the general rule that "...the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." (Emphasis supplied) The remainder of section 403(c), as well as section 403(d), contains various exceptions to the general rule. The exception that would be of interest in your present inquiry is in the opening phrase of section 403(c)(1), which exempts from the proscription against inurement those transactions described in section 4044, relating to the allocation of the assets of a defined benefit plan upon termination. That section permits transfer of assets to an employer after other required distributions have been made and obligations satisfied if certain conditions are met.

3(A). Sections 403 and 404 do not focus upon, nor normally require the Department to scrutinize, the intent of an employer in establishing a plan. Instead, these fiduciary responsibility provisions regulate the administration of the assets once the plan is in operation. In contrast, section 401(a) of the Internal Revenue Code and regulations thereunder indicate that a retirement plan qualifies for preferential tax treatment only if it is established for the exclusive benefit of employees or their beneficiaries.

3(B). Regardless of whether the Department received incontrovertible evidence that a plan was established in the interest of the employer rather than plan participants and beneficiaries, and even though the plan sponsor complied with all of the formal (procedural) requirements for plan establishment, there would be a fiduciary violation if the assets of the plan were not held for the exclusive purposes of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.

3(C). Section 403(c) does not refer to the intent of an employer when a defined benefit plan is established. See the answer to question 3(A).

4. Section 404(a)(1) requires that, subject to the same exceptions that apply to section 403(c)(1), a fiduciary shall discharge his or her duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. See also the answer to question 3.

5. While a "voluntarily established" pension plan is subject to specific fiduciary requirements (see question 2), nothing indicates that Title I applies to the "voluntary establishment" of a defined benefit pension plan. We are not aware of any presumption that the decision of an employer to terminate a plan is subject to ERISA fiduciary duty provisions. Of course, plan asset transactions, whether before or after termination, are subject to Title I.

6. Except as provided in the first sentence of section 403(c)(1), the first sentence of section 404(a)(1) and section 408(b)(9), the Department has not taken the position that the plan asset transactions following plan termination that are enumerated in section 4044 are expressly exempted from the fiduciary requirements of sections 403, 404 or 406.

7. The legislative history indicating that exemptions from section 406 are not also exemptions from section 404 has no effect on a decision to terminate a plan because that decision is not a fiduciary act subject to Title I of ERISA. Plan asset transactions before or after termination that are subject to Title I are subject to the prudent man standard of section 404. As a result, fiduciaries must take care so that none of their actions as fiduciaries endanger the receipt by participants and beneficiaries of everything they are entitled to under the plan.

8. There is no express language in section 4044 exempting the decision to terminate a pension plan from the fiduciary provisions of Title I. As explained in the answer to question 7, none is needed. See also the answer to question 6.

9. It is appropriate to view ERISA as supplementing, and in some cases superseding, prior conventional trust law.

10. The prohibited transaction sections of Title I supersede prior trust law by prohibiting a range of plan asset transactions involving potential conflicts of interest.

11. IRS regulations section 1.401-1(b)(2) does not appear to supersede trust law. It merely sets forth the income tax consequences of a premature termination.

12. There is a legislative pattern that indicates Congress intended to continue to permit plan terminations and the distribution of excess assets to employers. ERISA specifically contemplates the return of residual assets to an employer upon termination of a defined benefit plan. See section 403(c), which permits employer recoupment under specified circumstances; section 408(b)(9), which exempts from the prohibited transaction rules of section 406 the distribution of assets by defined benefit plans in a manner consistent with section 4044; and section 4044, which clearly allows reversions to employers. Courts have repeatedly approved these reversions on the strength of these provisions. See, e.g. Pollock v. Castrovinci, 476 F. Supp. 606, 616-17 (S.D.N.Y. 1979), aff'd 622 F.2d 575 (2d Cir. 1980). A separate issue is presented where a plan forbidding a reversion on termination is amended retroactively to permit such a reversion. See Audio Fidelity Corp. v. PBGC, 624 F.2d 513, 516-17 (4th Cir. 1980).

13. The IRS exercises exclusive responsibility to determine whether a plan initially complies with ERISA, that is, whether it complies on its face, assuming that representations made to the IRS in connection with the request for a determination letter are accurate, while Labor retains jurisdiction to determine whether the actual operation of a plan complies with Title I of ERISA. See also the answer to question 3(B). Thus, if in the operation of the plan a fiduciary engaged in violations of Title I of ERISA, the Department would not be precluded from bringing legal actions.

14. The Department has jurisdiction over all violations of the fiduciary provisions of Title I of ERISA, including those that may arise during the course of distribution of plan assets.

With regard to the second part of question 14, section 4044(d)(1) provides that:

> Any residual assets of a single employer plan may be distributed to the employer if--
>
> (A) all liabilities of the plan to participants and their beneficiaries have been satisfied,
>
> (B) the distribution does not contravene any provision of law, and
>
> (C) the plan provides for such a distribution in these circumstances.

This section of ERISA appears to give the PBGC authority to determine in the first instance whether "all liabilities...have been satisfied." Apparently construing this provision of section 4044, PBGC has promulgated a regulation published at 29 C.F.R. 2619.26, which provides in pertinent part:

> (a) Applicability. A benefit that is payable as an annuity under the provisions of a plan need not be provided in annuity form if--
>
> * * *
>
> (2) The present value of the benefit determined under this paragraph, is $1750 or less...
>
> (b) Valuation.
>
> * * *
>
> (2) The value of the lump sum or other alternative form of distribution payable under this section is the present value of the normal form of benefit provided by the plan payable at normal retirement age, determined as of the date of distribution using reasonable actuarial assumptions as to interest and mortality....
>
> (c) Actuarial assumptions. (1) The plan administrator shall specify the actuarial assumptions used to determine the value calculated under paragraph (b) of this section when the plan administrator submits the benefit valuation data to the PBGC pursuant to 2617.12 of Part 2617 of this chapter. The same actuarial assumptions shall be used for all such calculations. The PBGC reserves the right to review the actuarial assumptions used and to re-value the benefits determined by the plan administrator if the actuarial assumptions are found to be unreasonable.
>
> (2) The following interest assumptions are among those that will normally be considered reasonable.
>
> (i) The rate used by the plan for determining lump sum amounts prior to the date of termination. This rate may appear in the plan documents or may be inferred from recent plan practice.
>
> (ii) The rate used by the insurer in the qualifying bid under which the plan administrator will purchase annuities not being paid as a lump sum. (In the event

> the insurer does not provide the specific rate used, the rate may be estimated.)

* * *

It is the Department's view that ordinarily the use of interest assumptions that conform with requirements of the PBGC in the course of a plan termination will meet the fiduciary requirements of Title I of ERISA. See sections 408(b)(9), 403(c) and 404(a)(1) of ERISA.

15. There is nothing in ERISA or its legislative history to indicate that the decision by a plan sponsor to terminate a defined benefit pension plan is within the meaning of the term "transaction" as used in Title I of ERISA.

16. Not applicable.

17. Section 408(c)(3) merely provides that section 406 shall not be construed to prohibit a fiduciary from serving as a representative of a party in interest. The decision to terminate the plan is a corporate action; the implementation of the decision may involve fiduciary actions.

18. The use of plan assets to purchase outstanding shares of employer stock, as a part of a corporate strategy to avoid a possible takeover, might well violate the fiduciary provisions of ERISA.

19. ERISA's rules concerning the duties one fiduciary has with respect to the conduct of another fiduciary do not prescribe what particular action the first fiduciary should take. In the words of the ERISA Conference Report, at page 300, "The proper remedy is to be determined by the facts and circumstances of the particular case, and it may be affected by the relationship of the fiduciary to the plan and to the co-fiduciary, the duties and responsibilities of the fiduciary in question, and the nature of the breach." Section 405(a)(3) refers specifically only to breaches that have taken place or in which the first fiduciary participates. The Department points out, however, that section 405(a)(3) is not an exclusive provision. Thus, a fiduciary also must carry out any duties the fiduciary may have in a prudent manner under section 404(a)(1). Steps that might be appropriate for a fiduciary who knows of an impending breach include preparations to obtain an injunction from a Federal District court under section 502(a)(3), notification of the Labor Department, or publicizing the situation if a decision is made to proceed with the breach. Mere resignation, without taking steps to prevent the breach, would not suffice to avoid liability for the trustee once he or she has knowledge that

the breach is under consideration. See in this regard section 2509.75-5, FR-10, of the Department of Labor's regulations.

20. The Department did not independently review the calculation of individual lump sum payments with respect to the interest rates chosen. The Department relied on the opinion of PBGC that the calculation of individual lump sum payments did not require PBGC re-valuing the benefit. Section 4044(d)(1), which is administered by the PBGC, appears to give the PBGC authority to determine in the first instance whether "all liabilities...have been satisfied." Apparently construing this provision of section 4044, PBGC has promulgated a regulation published at 29 C.F.R. 2619.26; the pertinent part of the regulation is cited in the response to question 14 above.

Accordingly, PBGC requires the interest assumptions referred to above to be submitted along with the plan's benefit valuation data. In the instant case, PBGC initially issued a notice of sufficiency after being apprised of the Prudential bid which assumed certain lump sum cash outs. The Department reviewed the PBGC case file which included information regarding the calculation of lump sum payments.

With respect to whether the interest rate was equitable, the Department interviewed Towers, Perrin, Forster and Crosby, the actuary for the plan as well as reviewing PBGC's case file. Based on the information obtained during the interview and the fact that PBGC had reviewed the interest rate prior to issuing a notice of sufficiency, the Department determined to take no further action.

In any case, however, if the Department has information that a given situation involves a breach of any of the fiduciary duty provisions of ERISA, the Department would, under appropriate circumstances, exercise its authority to seek redress for such a breach of fiduciary responsibility.

21. The mere decision to amend an existing plan with restrictive limitations to permit a significantly higher percentage of investment in non-diversified employer securities is probably not subject to the fiduciary responsibility provisions of ERISA--specifically sections 404 and 406. Even if it were, there is nothing in ERISA to indicate that establishing or amending a plan to permit investments in employer securities, as opposed to the fiduciary decision to follow through and make these kinds of investments, could possibly violate the fiduciary provisions.

There is no question that a profit sharing plan containing a provision permitting the investment of, e.g., up to 50% of plan assets in qualifying employer securities, is legal. See section 407(b)(1) and section 404(a)(2) with respect to the waiver of statutory limitations and diversification requirements in connection with the acquisition and holding of qualifying employer securities by an eligible individual account plan, and section 408(e), which exempts these transactions from the prohibitions of section 406. Section 404 applies to the manner in which a fiduciary discharges his or her duties rather than to the type of investments from which a fiduciary may make a prudent choice.

Eaves v. Penn., 587 F.2d 453 (10th Cir. 1978) involved the conversion of a profit sharing plan to an ESOP and the subsequent looting of the ESOP by causing it to purchase vastly overpriced stock in the employer, after the employer corporation had gutted itself by contributing all of its cash to the ESOP. The scheme benefitted, among others, the former owners of the employer who sold their employer stock to the ESOP. The conversion to an ESOP was the first step in a pre-arranged scheme to mask the looting of the plan by causing it to purchase all of the stock in the employer from parties in interest at inflated prices. These facts are different from the Harper & Row situation. In Harper & Row, there was no allegation that the amendment of the profit sharing plan was part of a scheme to enable parties in interest to sell employer securities for less than their fair market value to the plan.

If an amendment in the Harper & Row situation is subject to ERISA's fiduciary liability provisions, then all amendments to employee benefit plans which authorize the reinvestment of existing plan assets in employer securities in a greater proportion than authorized by the original plan document could be viewed as violating, at a minimum, ERISA's exclusive purpose rule. Moreover, if the making of plan amendments is to be generally considered a fiduciary function, all plan revisions will have to be tested against all of ERISA's fiduciary standards, for we know of no way to limit this position to amendments permitting larger holdings of employer securities. Indeed, under this interpretation, one could argue that a plan fiduciary with the power to amend a plan would be required to use this power to alter vesting and benefit schedules in the best interest of plan participants and beneficiaries rather than in accordance with the wishes of the employer. The Department believes, instead, that the mere decision to amend a plan, not done as part of an overall scheme to engage in prohibited transactions, is not a fiduciary function, and therefore is not subject to the fiduciary provisions.

22. The Department received a letter from Michael Gordon, an attorney with Mittelman and Gordon, on August 10, 1982. The letter requested the Department to contact the Internal Revenue Service and request that it withdraw the favorable determination letter until the Department's investigation was completed. In the Department's opinion, the issuance of IRS determination letters had little, if any, effect on the Department's ability to take enforcement action as to the operator of the plan pursuant to section 502 of ERISA or to obtain appropriate relief under section 409 of ERISA. Therefore, the Department did not see a need to urge the IRS to suspend the issuance of the determination letter while the investigation was pending.

The Department carefully reviewed the opinion of Kidder, Peabody with regard to the purchase of employer stock by the Harper and Row Profit Sharing Plan. The opinion suggested that Harper and Row was under-priced at market. The Department has no reason to believe that this advice was in any way unsound. Indeed, although the price of a stock fell briefly following the purchase, the stock sold for more than its market price at the time of the purchase by the plan on March 2, 1983 (the sale was at 11 5/8 on December 9, 1981. The closing bid and asked on March 2, 1983 was 13 -- 13 3/8).

23. We have no disagreement with the PBGC's preamble's interpretation of the term "other provision of law" in section 4044. Nowhere does the PBGC regulation or statute give an instance where upon termination a reversion to an employer of residual assets that are not attributable to employee contributions would violate other provisions of law if the plan provides for reversion. That is consistent with the Department's prior testimony that--

> ...the provisions of ERISA make clear that where there is over-funding and where the plan so provides, the excess assets of the plan, that is, the amount in excess of that which is necessary to provide participants with their accrued benefits, may lawfully revert to the plan's sponsor upon complete termination so long as the distribution does not contravene any provisions of law.

24. Under section 404(a)(1), a plan fiduciary must act in a prudent manner in carrying out all fiduciary duties. Because termination is, as your question indicates, an act done by a plan sponsor rather than by a fiduciary qua fiduciary, a fiduciary would not generally have a duty to inquire into the circumstances under which the plan sponsor terminates the plan. Of course, if a prudent person would have cause to

question whether the plan sponsor had in fact terminated the plan, then the fiduciary should make an appropriate investigation.

25. Because the decision to terminate a plan is not a fiduciary decision, the doctrine of Bierwirth does not apply. It is irrelevant whether the result of the termination will be the reversion of a substantial amount of surplus assets to the employer.

26. Under ERISA, plan fiduciaries do not have a duty to resist the implementation of a plan sponsor's decision to terminate the plan. Thus, for instance, in the case of a potential takeover where officials of a corporate sponsor cause the plan to be terminated in order to use excess plan assets to buy controlling shares of the sponsor's stock in order to prevent a takeover, the plan's fiduciaries do not have a duty under ERISA to resist the termination on the grounds that the termination was the result of the undue influence of corporate officials who were seeking to entrench themselves. The trustees of Grumman Corporation would not have violated their fiduciary duties under ERISA by not resisting plan termination merely because, under circumstances otherwise identical to the actual circumstances, corporate officials had terminated the pension plan and had surplus assets properly transferred to the plan sponsor, which used those assets, now corporate assets rather than plan assets, to buy up Grumman stock.

27. An employer has no obligation under ERISA to maintain a certain level of benefits or to maintain in existence any particular benefit plan. Nor does ERISA require the employer to seek shareholder approval prior to a decision to terminate a plan. The creation and maintenance of employee benefit plans by employers is voluntary under ERISA. The Department of Labor is not responsible for interpretation of section 4044(d) of ERISA; to our knowledge, the question posed has not been definitively resolved by the PBGC or a court. If plan fiduciaries have knowledge of fiduciary breaches, they would be required to take remedial action; to the extent that their knowledge relates to violations of other duties, however, they are not necessarily required to take remedial action.

28. Under section 404(a)(1)(D), the fiduciaries of a plan are responsible for carrying out their duties in accordance with the documents and instruments governing the plan insofar as they are consistent with Titles I and IV of ERISA. Often they may use agents in the course of carrying out these duties. If they or their agents do not properly carry out these duties and, as a result, the plan suffers a loss, they may be in violation of ERISA and consequently personally liable to

reimburse the plan for those losses. Anyone who performs fiduciary duties is a fiduciary regardless of his or her title.

29. Fiduciaries who are determining lump sum benefits are subject to all the Title I fiduciary duties. See also the answer to question 14.

30. The Department is concerned about the use of pension plans as weapons in corporate takeover wars. In the Department's view, it is improper for corporate management to use plan assets either to aid plan sponsors in taking over corporations or to defend their corporate positions against a takeover attempt. Under ERISA section 404(a)(1), plan fiduciaries have a sole, overriding obligation to make decisions with respect to the purchase or sale of securities on the part of the plan solely on the basis of what is best for the plan participants and beneficiaries. The Department has expressed these views to the courts in two different situations--first in Donovan v. Bierwirth, where corporate management used the assets of its pension plan to defend against a corporate takeover, and more recently in Donovan v. Simmons, in which the Department alleged that the defendants used plan assets which they controlled in an illegal manner to effectuate a takeover.

The Department was informed of an attempted takeover of Graniteville Corporation and Graniteville's defensive tactics. We are currently investigating the situation.

31. Section 407(d)(5) of ERISA defines the term "qualifying employer security" to mean an employer security which is stock or a marketable obligation. Neither ERISA nor the accompanying Conference Report sheds any further light on which attributes stock must possess before it can be properly held by a plan. Therefore, in the Department's view, the prohibited transaction provisions of section 406 of ERISA do not absolutely preclude the contribution to a plan of employer stock which is subject to restrictions on the plan's right to sell the stock or the plan participant's right to vote the stock. The Department notes that preferred stock which may be contributed to a plan ordinarily does not entitle the holder of such stock to voting rights unless dividends are in arrears for a certain period of time. We believe that to rule out contributions to a plan of preferred stock would not be in the best interests of sound plan administration. We further note that Congress, in amending section 401(a)(22) of the Internal Revenue Code of 1954, specifically excluded profit-sharing plans from the requirement that defined contribution plans provide pass-through of voting rights to plan participants.

Section 404(a)(1) of ERISA requires that a fiduciary discharge his or her duties with respect to a plan solely in the interest of the participants and beneficiaries, and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the fiduciaries of a plan must act "prudently" and "solely in the interest" of a plan's participants and beneficiaries when deciding whether to accept a contribution of stock subject to restrictions on marketability.

32. Section 404 would apply to a decision by a plan fiduciary to sell high grade debt and equity securities in order to purchase employer common stock. Whether that course of action would violate that section would depend on the facts and circumstances of the case. If the action were taken primarily to benefit an employer and caused a plan to suffer a loss, the fiduciary would be liable for losses. The Department is very concerned that this kind of activity not happen, and places a high priority on enforcement action where it discovers it.

33. It is not at all clear that a plan would sustain any damage as a result of a situation in which a plan receives no less than fair market value from the sale of securities and then pays no more than fair market value for the acquisition of other securities. If, however, a situation involves a breach of the fiduciary provisions of ERISA, and a loss occurs as a result of that breach, the amount of the loss would be the appropriate measure of damages.

34. As we have indicated, the decision to terminate a plan is a business decision not a fiduciary decision. Thus to the extent the spinoff is a termination, the decision to undertake the spinoff is not a fiduciary decision.

35. Section 404 requires plan fiduciaries to carry out their duties in accordance with plan documents, consistent with ERISA. Section 406 prohibits the transfer of plan assets to a party in interest unless an exemption applies. Thus, with respect to the voluntary termination of an employee contributory defined benefit pension plan, the failure of a plan sponsor to equitably distribute residual employee contributions to plan participants and beneficiaries under section 4044(d)(2) would represent fiduciary violations. Precisely which provisions were violated would depend upon what the fiduciary did with the assets. If, for instance, an employer fiduciary had the assets transferred to itself under those circumstances, sections 403(c)(1), 404, 406(a)(1)(D), 406(b)(1) of ERISA and sections 4975(c)(1)(D) and (E) of the Internal Revenue Code would all be violated.

I trust that these responses prove helpful to your important work.

Sincerely,

Robert Monks

Robert A.G. Monks
Administrator
Office of Pension and Welfare
  Benefit Programs

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Select Committee on Aging
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January 12, 1984

A-3

The Honorable Donald Regan
Secretary of Treasury
Department of Treasury
15th and Pennsylvania Avenue
Washington, D.C. 20220

Dear Mr. Secretary:

As you are aware, on September 28, 1983, Mr. S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations of the Internal Revenue Service (the Service), testified at a hearing of the House Select Committee on Aging (the Committee) concerning pension asset "raids." In brief, Mr Winborne testified that the law would need to be changed in order to prevent reversions of excess assets to plan sponsors following the voluntary termination of defined benefit pension plans. He also testified that the Internal Revenue Service is giving serious consideration to the issue of "overfunded" pension plan terminations in general and is attempting to determine whether, with respect to certain "spin-off" terminations and reversions, such actions are merely "gimmicks" aimed at recapturing excess assets, noting that the Service hoped to take a position on this issue soon.

I am concerned that the present policy of the Service, as described by Mr. Winborne, as well as some of the proposals apparently being considered by the Department of the Treasury (the Department) and the Service misapprehends, in part, some of the Committee's concerns regarding harms suffered by plan participants as a result of recent "overfunded" defined benefit pension terminations. I am therefore requesting that the public policy and legal positions adopted by the Service to date be reviewed to determine whether the Department's and the Service's position on these matters are consistent with and protective of the benefit rights of plan participants and beneficiaries under the requirements of the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA).

The role of the Service is crucial. The most recent data supplied to the Committee by the Pension Benefit Guaranty Corporation (the Corporation) indicates that more than $517 million has reverted to plan sponsors through the termination of 138 defined benefit pension plans. The number of significant pending terminations has tripled since initial data was compiled for the Committee by the Corporation; the Committee's estimate of total reversions, including pending terminations, now exceeds $1.8 billion.

The unprecedented wave of plan terminations deserves careful scrutiny by the Department and the Internal Revenue Service. To date, the Service has sanctioned the reversion of over $500 million of plan assets under the guise of "actuarial error." Many of these terminations were designed for no other apparent purpose than to facilitate the recapture of "surplus" plan assets by permitting plan sponsors or their officials to strip long-established and well-financed plans of so-called "excess" assets. Some of these proposed terminations may, in the words of Mr. Winborne represent "gimmicks". Termination of "overfunded" defined benefit plans in this manner may represent not only tax abuse, but a systematic undermining of the retirement income security of affected plan participants and beneficiaries.

Mr. Winborne testified at the hearing that if reversions of "excess" assets are to be prevented, legislation to amend the Internal Revenue Code would be required. By framing the issue in this manner, Mr. Winborne appears to have misconstrued one of the Committee's basic concerns. While I and a number of members of the Committee are concerned about the loss of security of potential benefits to workers and their families through such terminations, we are also concerned about the mechanisms through which such apparent surpluses are created.

In a letter dated December 15, 1981 from then Chairman Claude Pepper, Ranking Minority Member Matthew Rinaldo and Rep. Geraldine Ferraro to Commissioner Egger generally concerning the proposed termination of the defined benefit pension plan of the Great Atlantic and Pacific Tea Co., Inc. (A&P Stores), the Committee expressed a concern about "overfunded" plan terminations which might jeopardize the retirement security of workers. The letter noted that "Members of the Select Committee on Aging are becoming increasingly concerned that many plans are adopting overly optimistic interest rate assumptions in order to lower the required contributions by employers to these plans. Plans may, through this same adjustment of assumptions, appear to have an excess of funding as compared to actuarial liabilities...(C)ertainly during this period of economic stress on many companies both large and small, the presumably overfunded plan may present an attractive reservoir of monies conveniently available to meet the employer's own priorities and needs."

The response of the Treasury Department dated March 17, 1982 merely recites the Code requirements respecting minimum funding, payment of accrued benefits and that surplus assets attributable to actuarial error may be reverted. Apparently little attention was or has been focused on whether or not interest rate assumptions were being orchestrated to produce certain salutory affects for an employer. (See attached articles)

The written testimony submitted by Mr. Winborne refers to the Committee's interest in the Service's regulation section 1.402-1 (b) (2), and the [illegible] "erroneous actuarial computation," as it relates to the reversion of "excess" assets to plan sponsors. The position of the Department and the Service regarding the role of "actuarial error" in the reversion of plan assets seems to present a contradiction. Mr. Winborne testified that many plans are funded on a level basis, so that they are essentially designed to be overfunded during the early years of the plans' life. He then went on to state that even though a plan may have excess assets upon termination, which are considered to be the result of "erroneous actuarial computations," this does not mean "that mistakes in the usual sense were made by actuaries." Mr. Winborne conceeds that in may cases the "excess" assets result not from experience gains on plan investments, but primarily because the plan was funded on a level basis and terminated early in its life at a time when it was designed to have a surplus.

Yet, in a letter to the Committee from Mr. Winborne dated September 2, 1983, containing background materials regarding section 1.401-2 (b) (1) of the Service's regulations and the term "erroneous actuarial computations," the following language is found:

> For example, if the trust created to supply pensions of $25 a month for 10,000 employees for the remainder of their lives after age 60 has been used to supply pensions to only 500 employees, an amount remaining in the trust for this reason is not due to (actuarial error), but to a change in the plan. (emphasis added)

I see little or no difference between this form of plan change and the situation which has been repeated so often during this trend of voluntary terminations: a plan sponsor, fully aware that plan assets exceed plan liabilities, terminates the pension plan in order to recapture the excess assets. In both cases the "surplus" is not the result of an erroneous computation, but represents a deliberate act of the plan sponsor to change a plan provision or an assumption on which the actuarial calculations were based, thus changing the plan itself. In the former case, the plan sponsor changes the plan so that it provides benefits for half as many employees; in the latter, the plan sponsor changes the plan by shortening the period of time over which benefits can accrue.

The text of the Service's September 2, 1983 letter itself seems to support this view. In it Mr. Winborne explained the Service's treatment of "erroneous actuarial computation" in the following terms:

> Generally surplus assets arising on the termination of a pension plan are considered by the Service as being the result of actuarial error unless the surplus is attributable to actions designed to create the surplus. (emphasis added)

Further, under section 401 of the Internal Revenue Code (the Code) and section 1.401-1 (b) (2) of the regulations, a plan is established with a required presumption that the plan will be permanent. This presumption raises a question. For example, section 1.401-1 (b) (2) includes a business necessity test for plans that are terminated shortly after they were established on a presumptively permanent basis. If the actuary is required by the Code and regulations to design the plan on the assumption that it will be on-going, how can a surplus arising from the plan sponsor's decision to terminate the plan and recapture "excess" assets be the result of actuarial error rather than a change in the plan?

One of the fundamental issues before the Department and the Service is not only whether plan sponsors should be permitted to recapture "surplus" assets under certain circumstances, but also what precisely constitutes "erroneous actuarial computations." Unfortunately, present Service regulations seem to provide no clear guidance. Moreover, relevant revenue rulings have tended to obscure rather than illuminate the meaning and application of this term.

On June 24, 1983, Mr. Winborne supplied to the Committee background materials for three Revenue Rulings: 71-152, 73-55 and 83-52. Among those materials was a memorandum dated June 9, 1971, concerning the preparation of what was to become Rev. Ruling 73-55. It states that the writer believed it "desirable that the Revenue Ruling give a clearer indication of what an actuarial error is."

In a technical assistance memorandum dated August 28, 1972 the following seems to respond to this concern:

> However, we prefer to limit the scope of this Rev. Rul. to the single issue under consideration without going into the probably controversial question of what an actuarial error is at this time. (emphasis added)

Thus the issue of what constitutes actuarial error was squarely before the Department and the Service more than ten years ago, with little subsequent clarification forthcoming.

I urge you to fully reconsider the treatment of "actuarial error" by the Department and the Service, in light of the over one-half billion dollars already returned to plan sponsors ostensibly as the result of "actuarial error," and literally a billion or more poised for similar recapture.

Another area of concern involves distribution of lump sums to participants. Prior to Rev. Rul 83-52, the calculation of lump-sum distributions were governed by the requirement of Rev. Rul 71-152 that such cash-outs be calculated using interest rates no less conservative than those used to calculate costs during the life of the plan. Under Rev. Rul. 83-52, these lump-sum distributions may now be calculated using the interest rate assumptions of annuity contracts purchased to satisfy benefits accrued by employees upon termination, whose accrued benefits have a present actuarial value of $1,750 or less.

As a result, lump-sum distributions have been calculated with interest rate assumptions as high as 15%. It is virtually impossible for an employee to take such a small lump sum and invest it so as to receive a return equal to this interest rate assumption. Even if such investment opportunities exist, most employees receiving lump-sum payments are not in a position to obtain adequate retirement coverage from these distributions. The result of this new policy under Rev. Rul. 83-52 is that many employees who are "cashed-out" when the plan is terminated do not receive the true present value of their accrued benefits.

The use of extremely high interest rates means more employees are cashed-out rather than receiving some kind of periodic benefit at retirement. If an employee changes jobs several times during his or her working life, the employee may reach retirement age without ever vesting in a retirement benefit.

This present formulation of cash-outs under Service rules, as a matter of policy, seems to jeopardize rather than secure the retirement income security of workers. First, many employees consume their lump-sum distributions in commercial purchases rather than investing these sums for retirement income. Thus, Rev. Rul. 83-52 contains a de facto disincentive for retirement savings — precisely the opposite effect of the intended policy of ERISA and so much other recent legislation. Second, by fostering a climate where more employees are cashed-out, the Department and the Service are implicitly fostering a policy which favors the distribution of retirement income in the form of lump-sum cash payments. Many employees are not in a position to prudently manage their retirement investments, a fact recognized by Congress when it established a policy favoring the creation of defined benefit plans. Such a policy becomes more distressing when there is some likelihood that the Congress may shortly pass legislation which will increase the cash-out limitation from $1,750 to $3,500, thus increasing the possibility that more workers may not achieve retirement security. (See H.R. 2769 passed by the Senate on November 18, 1983.)

The Committee heard ample testimony at the September 28 hearing that the interest rates permitted under Rev. Rul 83-52 serve as an incentive for plan sponsors to terminate their defined benefit plans. In fact, background materials for Rev. Rul. 83-52, supplied to the Committee by Mr. Winborne, indicate that the Service was at least partially conscious of the consequences of the new rule. A routing and approval record (date illegible) clearly states that, as compared to an annuity interest rate, for example,

> The assumptions used by plans to determine funding will generally produce higher distributions (and correspondingly lower reversions to the employer)....

One apparent effect of this change has been to induce more employers to terminate plans at an alarming rate. One plan sponsor, which was funding its pension plan with a 7% interest rate assumption in 1980, terminated its plan in 1981 and bought annuity contracts to satisfy accrued benefits that used a 15% interest rate assumption. Under the rule of 83-52, employees receiving lump-sum distributions would have the present value of their accrued benefits calculated at more than double the interest rate that generally would apply under Rev. Rul. 71-152, with their lump-sum distribution reduced exponentially as a result.

Perhaps the effects of Revenue Ruling 83-52 were not fully appreciated when it was drafted. I do not hesitate to point out, however, that this Committee held a hearing discussing the effect of "overfunded" plan terminations on plan participants on June 7, 1982, ten months before Rev. Rul. 83-52 was released. Mr. Winborne also testified at that hearing, voicing essentially the same position that he articulated at the September 28 hearing. There can no longer be any doubt however, as to the magnitude of the problem facing those employees presently covered by overfunded defined benefit plans.

I am concerned that any possible solution ultimately fashioned by the Agencies to respond to these terminations must be tempered with an appreciation of the public policy and specific fiduciary considerations involved in this area. In this regard, I and other members of this Committee are concerned that the views of all responsible federal agencies, including the Department of Labor, be ellicted in the development of any proposal or suggested solution to this area of concern.

Moreover, it is my concern that at this juncture the Department and Service, in consultation with the Department of Labor and the Corporation, move carefully and critically within their administrative authority to determine the appropriate legal characterization and policy view for proposed "spinoff" terminations. Under such a proposed termination, an overfunded defined benefit pension plan would be divided with retired and separated participants and surplus assets removed and, subsequently, a new and substantially similar defined benefit established for active participants. While I am aware of the processing constraints which must be observed for applications for plan termination, I am concerned that in the absence of such a critical review of this form of proposed termination and its relationship to the broader questions involved in this area, that any final disposition of this type of proposed termination may represent a precedent or may serve to restrict consideration of those range of options that may be necessary to ensure adequate protection of plan participants and beneficiaries. Certainly pertinent provisions of the Code as well as provisions of Title IV of ERISA raise very serious considerations with respect to this formulation of proposed termination. Particularly whether such an arrangement may constitute a valid termination for purposes Title IV of ERISA would seem to be a vital concern with respect to the application of Code and Title I fiduciary requirements.

Finally, I would like to pose several questions with respect to relevant provisions of the Code and of the regulations as they relate to the termination of an "overfunded" defined benefit pension plan.

1. In a letter to this Committee dated September 2, 1983, the Service describes surpluses which arise from actuarial error in the following manner, ". . .Generally, surplus assets arising on the termination of a pension plan are considered by the Service as being the result of actuarial error unless the surplus is attributable to actions designed to create the surplus." (emphasis added). If a plan is intentionally terminated at a time when the plan is designed to be overfunded under the funding method used, can the surplus be the result of "erroneous actuarial computations"?

2. Since actuaries are constrained to assume that the plan was established with the present intention that it be "permanent" under Code section 1.401-1 (b)(2), is the intentional termination of a plan to reach surplus assets a "change in the plan" rather than a mistake on the part of the enrolled actuary?

3. Revenue Ruling 83-52 contains an implicit presumption that surpluses remaining after plan liabilities are satisfied "may be considered surplus arising from actuarial error," apparently without proof as to the actual source of the surplus? Why is this presumption embodied in this ruling and does the Service attempt to determine, beyond the facial statements of an applicant, whether and how such surplus amounts arise?

4. Why were the provisions of Revenue Ruling 83-52 made retroactively effective and will this affect in any way the amounts which may be distributable to plan participants and beneficiaries under the provisions of the eariler revenue ruling?

5. I would like to obtain the Service's position on Service regulation section 1.401-6 as it relates to a termination of defined benefit pension plan and the subsequent creation of a "comparable" plan by a plan sponsor. Specifically, section 1.401-6(b) provides in pertinent part that:

> (b) Termination defined. (1) Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. For example, a plan is terminated when, in connection with the winding-up of the employer's trade or business, the employer begins to discharge his employees. However a plan is not terminated, for example, merely because an employer consolidates or replaces that plan with a comparable plan. Similarly, a plan is not terminated merely because the employer sells or other wise disposes of his trade or business or the acquiring employer continues the plan as a separate and distinct plan of its own, or consolidates or replaces that plan with a comparable plan. See paragraph (d)(4) of § 1.381(c)(11)-1 for the definition of comparable plan. In addition, the Commissioner may determine that other plans are comparable for purposes of this section. (emphasis added).

Has the Service previously construed this provision to preclude the creation of a new "comparable" plan , whether defined benefit or defined contribution, after the termination of a defined benefit pension plan? Moreover, what is the relevance of this provision to those proposed termination arrangements involving both "spinoffs" and the termination of a defined benefit plan which is followed by creation of a "comparable" defined benefit plan? Please furnish copies of any relevant opinions or advice which have been issued by the Service on application of this provision.

6. Service regulation section 1.411 (d)-2(b) provides in pertinent part that:

> If a defined benefit plan ceases benefit accruals or decreases future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer, or employees maintaining the plan (determined as of the date of the cessation or decrease is adopted) is created or increased. (emphasis added).

Has this provision previously been applied to a termination of a defined benefit plan and the creation of a new plan of the same plan sponsor? Does this provision have relevance to proposed "spinoff" and defined benefit followed by defined benefit arrangements?

7. Have the "step transaction" and "business purpose" doctrines previously been applied by the Service to situations involving the termination of a defined benefit pension plan? What is the position of the Service with respect to these doctrines as they relate to proposed "spinoff" terminations and defined benefit followed by defined benefit arrangements? Please furnish copies of any applicable opinion or advice furnished by the Service?

Also, I would like to request from the Service a description of whether it has previously issued any favorable determination letter or any other pertinent ruling or advice regarding a situation in which a defined benefit plan is terminated and subsequently, the plan sponsor establishes a new and substantially similar defined benefit pension plan. If such a favorable ruling or position has previously been taken by the Service on such an arrangement, please describe the Code and regulatory basis upon which such a favorable position was taken.

The principle purpose of the Internal Revenue Code requirements governing the qualification of pension plans is to seek to protect the retirement security of American workers. In light of the concerns expressed herein regarding Mr. Winborne's testimony as well as the policy questions raised both in this letter and by various expert witnesses at our Committee hearing, I ask that you personally review the legal and public policy positions of the Department of Treasury and the Internal Revenue Service with respect to terminations and reversions.

In addition, I would like to obtain from you a description of those proposals that are presently being considered by the Department of Treasury and the Service in this area to facilitate the Committee's continuing review of the area.

The Committee and I request an expeditious reply to this letter.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR/mw

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

A-4

MAR 4

The Honorable Edward R. Roybal
Chairman, Select Committee on Aging
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of January 12, 1984, to Mr. Donald Regan, Secretary of the Treasury, expressing concern with respect to participants' interests as a result of recent terminations of overfunded defined benefit pension plans. In that letter you requested that the Internal Revenue Service review its policies regarding the termination of defined benefit plans, where excess assets revert to employers, to determine whether such policies are consistent with the requirements of the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA).

As you know, Mr. S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations of the Internal Revenue Service, testified before your Committee, on September 28, 1983, that the Service was concerned about these plan terminations and was studying what positions could be taken with respect to certain plan terminations where there is recovery of excess assets. These cases include terminations either in conjunction with the establishment of a new, substantially similar plan or in conjunction with the spinoff of a portion of the assets and liabilities of a plan for active participants and the termination of the portion of the plan for retired participants. To this end, we have instructed our key district offices to request technical advice from the National Office in all determination letter cases in which a defined benefit plan is terminating with an expected reversion in excess of one million dollars. In addition, we have been meeting with the Department of Labor (DOL) and with the Pension Benefit Guaranty Corporation (PBGC) to discuss this matter.

Your letter also posed seven questions relating to plan terminations. The full text of each question and our answer is set forth below:

Question 1. In a letter to this Committee [the Select Committee on Aging], dated September 2, 1983, the Service describes surpluses which arise from actuarial error in the following manner, "...Generally, surplus assets arising on the termination of a pension plan are considered by the Service as being the result of actuarial error unless the surplus is attributable to actions designed to create the surplus." (emphasis added). If a plan is intentionally terminated at a time when the plan is designed to be overfunded under the funding method used, can the surplus be the result of "erroneous actuarial computations"?

Department of the Treasury   Internal Revenue Service

Answer: Yes, the surplus assets existing at plan termination, as described in your question, can be the result of erroneous actuarial computations. Under section 1.401-2(b)(1) of the Income Tax Regulations, upon termination, surplus plan assets, which are the value of plan assets in excess of the value of plan liabilities, result from "erroneous actuarial computations", except to the extent such surplus or excess was created or increased by changes in the plan, such as a reduction in existing plan benefits. Under various recognized methods of funding, a plan may be overfunded prior to termination, that is, accumulate assets in excess of the value of plan benefits, because of the desire of an employer to have relatively constant year-to-year costs. The termination of such a plan prevents future increases in plan benefits but does not reduce existing plan benefits, and the existing surplus assets upon termination can be the result of erroneous actuarial computations.

Question 2. Since actuaries are constrained to assume that the plan was established with the present intention that it be "permanent" under Code section 1.401-1(b)(2), is the intentional termination of a plan to reach surplus assets a "change in the plan" rather than a mistake on the part of the enrolled actuary?

Answer: An intentional termination is not a change in the plan that creates the surplus plan assets. Section 1.401-1(b)(2) of the regulations provides that although the term "plan" implies a permanent as distinguished from a temporary program, the employer may retain the right to terminate the plan at any time. The regulations further state that termination of the plan within a few years of its inception will be taken as evidence that the plan was intended to be a subterfuge if it is terminated for any reason other than business necessity. Revenue Ruling 69-25, 1969-1 C.B. 113, presumes a permanent intent except where there is clear evidence to the contrary, such as certain cases involving termination within a few years after adoption. The termination of a plan that is deemed to have been intended to be a permanent program is a plan change that does not violate the permanency requirement. As stated above, surplus plan assets existing at the time of this plan change can result from erroneous actuarial computations.

Question 3. Revenue Ruling 83-52 [1983-1 C.B. 87] contains an implicit presumption that surpluses remaining after plan liabilities are satisfied "may be considered surplus arising from actuarial error," apparently without proof as to the actual source of the surplus? Why is this presumption embodied in this ruling and does the Service attempt to determine, beyond the factual statements of an applicant, whether and how such surplus amounts arise?

Answer: The Service does attempt to determine, beyond the factual statements of an applicant, the conditions under which surplus assets arise. In this regard, section 1.401-2(b)(2) of the regulations states:

> A balance due to an "erroneous actuarial computation" is the surplus arising because actual requirements differ from the expected requirements even though the latter were based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan and were made by a person competent to make such determinations in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding. For example, a trust has accumulated assets of $1,000,000 at the time of liquidation, determined by acceptable actuarial procedures using reasonable assumptions as to interest, mortality, etc., as being necessary to provide the benefits in accordance with the provisions of the plan. Upon such liquidation it is found that $950,000 will satisfy all of the liabilities under the plan. The surplus of $50,000 arises, therefore, because of the difference between the amounts actuarially determined and the amounts actually required to satisfy the liabilities. This $50,000, therefore, is the amount which may be returned to the employer as the result of an erroneous actuarial computation. If, however, the surplus of $50,000 had been accumulated as a result of a change in the benefit provisions or in the eligibility requirements of the plan, the $50,000 could not revert to the employer because such surplus would not be the result of an erroneous actuarial computation.

In accordance with the above regulations, in the absence of a plan change to create or increase the amount of surplus assets, there is a presumption of erroneous actuarial computations when the value of obligations is less than the value of plan assets. Rev. Rul. 83-52 restates this position in view of ERISA and, in particular, Title IV of ERISA, but does not preclude the possibility referred to in the last sentence of the regulations cited above that certain surplus assets can not revert to the employer in compliance with the Code. In this regard, there are many interrelated factors affecting the development and amount of surplus assets in a terminating pension plan: the actual employer contributions, investment performance, employee turnover, mortality and retirement experience, the benefit accrual method, the vesting provisions and the factors, primarily interest, available for valuing plan liabilities upon termination. The source of surplus assets attributable to erroneous actuarial computations is the combined effect of these factors.

Other possible sources of surplus assets are looked for by the Service. Thus, the applicant for a determination letter upon plan termination must answer a question regarding any plan amendments reducing plan benefits. Also, the Service is currently requiring cases involving a reversion of surplus assets in excess of $1,000,000 to be sent to the National Office for further review regarding the circumstances of the surplus assets.

Question 4. Why were the provisions of Revenue Ruling 83-52 made retroactively effective and will this affect in any way the amounts which may be distributable to plan participants and beneficiaries under the provisions of the earlier revenue ruling?

Answer: Whenever there is a change in the provisions of the law, especially the massive changes occasioned by the passage of ERISA, a period of time is needed for the Service to examine previously issued rules in view of these changes and to republish existing rules or publish new rules as needed. This process has been long and difficult following ERISA, and it continues still. It is quite common, as rules are written or rewritten, for the new or revised rules to have retroactive effect consistent with the effective date of the changes in the law and reasonable actions of taxpayers.

With respect to Rev. Rul. 83-52 and its updating of Revenue Ruling 71-152, 1971-2 C.B. 126, and Revenue Ruling 73-55, 1973-1 C.B. 196, both of these earlier revenue rulings were issued before ERISA. Title IV of ERISA provides for the valuation of plan assets and liabilities in terminating defined benefit plans that are subject to ERISA's termination insurance provisions. Rules for such valuation were published by the PBGC. Consequently, it is appropriate that Rev. Rul. 83-52, which permits use of the PBGC's rules, has retroactive effect. Such retroactive effect would mean that the qualification of a plan would not be adversely affected merely because prior to the issuance of Rev. Rul. 83-52, distributions upon plan termination had been made using assumptions permitted by the PBGC's rules rather than using assumptions specified by Rev. Rul. 71-152.

Question 5. I would like to obtain the Service's position on Service regulation section 1.401-6 as it relates to a termination of a defined benefit pension plan and the subsequent creation of a "comparable" plan by a plan sponsor. Specifically, section 1.401-6(b) provides in pertinent part that:

> (b) Termination defined. (1) Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. For example, a plan is terminated when, in connection with the winding up of the employer's trade or business, the employer begins to discharge his employees. However a plan is not terminated, for example, merely because an employer consolidates or replaces that plan with a comparable plan. Similarly, a plan is not terminated merely because the employer sells or otherwise disposes of his trade or business if the acquiring employer continues the plan as a separate and distinct plan of its own, or consolidates or replaces that plan with a comparable plan. See paragraph

> (d)(4) of section 1.381(c)(11)-1 for the definition of comparable plan. In addition, the Commissioner may determine that other plans are comparable for purposes of this section. (emphasis added).

Has the Service previously construed this provision to preclude the creation of a new "comparable" plan, whether defined benefit or defined contribution, after the termination of a defined benefit pension plan? Moreover, what is the relevance of this provision to those proposed termination arrangements involving both "spinoffs" and the termination of a defined benefit plan which is followed by creation of a "comparable" defined benefit plan? Please furnish copies of any relevant opinions or advice which have been issued by the Service on application of this provision.

Answer: Section 1.401-6(b)(1) of the regulations, published in 1963, defined "termination" for the purposes of section 401(a)(7) of the Code that existed prior to ERISA. Pursuant to ERISA, the relevant provisions of that section became new section 411(a)(3) of the Code. Section 1.401-6(b)(1) generally is not applicable to "spinoff" arrangements as referred to in your letter and does not relate to the "exclusive benefit" provision of section 401(a) of the Code, but rather to the nonforfeitability of employees' benefits. This section of the regulations does not preclude the creation of a new "comparable" plan after the termination of a plan, but instead provides an exception to the nonforfeitability requirements upon plan termination in the event a plan is replaced by a "comparable" plan. Further, section 1.401-6(b)(1) no longer applies to any plan other than a plan not subject to section 411(d) of the Code.

Regulations under new section 411(d)(3) have been issued but do not retain the concept of a "comparable" plan. Plans that are subject to section 411 include the plans that have been of interest to your Committee, and the Service applies the presently effective Code provisions and regulations to current terminations of these plans. Accordingly, we have not included copies of any Service opinions or advice in this regard.

Question 6. Service regulation section 1.411(d)-2(b) provides in pertinent part that:

> If a defined benefit plan ceases benefit accruals or decreases future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer, or employers maintaining the plan (determined as of the date of the cessation or decrease is adopted) is created or increased. (emphasis added).

Has this provision previously been applied to a termination of a defined benefit plan and the creation of a new plan of the same plan sponsor? Does this provision have relevance to proposed "spinoff" and defined benefit followed by defined benefit arrangements?

Answer: Section 411(d)(3) of the Code requires an employer to fully vest all affected employees in their accrued benefits to the extent such benefits are funded in the event of the termination or the partial termination of a qualified plan. The determination that a plan termination or partial termination of a plan has occurred will depend on the surrounding facts and circumstances.

Section 1.411(d)-2(b) of the regulations deems that a partial termination will occur where a decrease in or cessation of future benefit accruals in a defined benefit plan gives rise to a potential reversion to the employer. The purpose of this provision is not to prevent plan terminations but simply to provide the rules for a particular set of circumstances regarding nonforfeitability of benefits accrued. This provision of the regulations would apply in any case of a termination of a plan regardless of whether or not the same plan sponsor creates a new plan. Generally, this provision is not applicable in the case of a "spinoff" arrangement as referred to in your letter unless there is a cessation of benefit accruals.

Question 7. Have the "step transaction" and "business purpose" doctrines previously been applied by the Service to situations involving the termination of a defined benefit pension plan? What is the position of the Service with respect to these doctrines as they relate to proposed "spinoff" terminations and defined benefit followed by defined benefit arrangements? Please furnish copies of any applicable opinion or advice furnished by the Service?

Answer: The Service has not adopted any general "step transaction" or "business purpose" doctrine (which we understand to refer to plan terminations involving reversions of plan assets to an employer in conjunction with a spinoff or the establishment of another defined benefit plan) to the termination of a defined benefit plan. Whether or not any such approach is feasible for the Service to adopt is currently under study. Accordingly, there are no relevent copies of any opinions or advice to be furnished in this regard.

In addition to the above questions, you also requested from the Service a description of whether it has previously issued any favorable determination letter or any other pertinent ruling or advice regarding a situation in which a defined benefit plan is terminated and subsequently, the plan sponsor establishes a new and substantially similar defined benefit pension plan.

The Service has issued favorable determination letters under the circumstances you describe. However, because we do not keep specific statistics on this particular issue, we are unable to tell you how many times such letters may have been issued.

Finally, regarding your request for a description of IRS-Treasury proposals in this area, we are meeting with the DOL and with the PBGC to explore a wide spectrum of ideas and considerations and to develop these into proposals. When these discussions yield definitive results, we will make them available to your Committee.

I hope our responses have been helpful to your Committee.

With kind regards,

Sincerely,

Roscoe L Egger

U.S. House of Representatives
Select Committee on Aging
Washington, D.C. 20515

January 25, 1985

A-5

Mr. S. Allen Winborne
Assistant Commissioner
Employee Plans and Exempt Organizations
Internal Revenue Service
1111 Constitution Ave. N. W. Rm. 3408
Washington, D. C. 20224

Dear Mr. Winborne:

It has come to the attention of the House Select Committee on Aging (the Committee) that the Internal Revenue Service (the Service) has recently issued an information letter under section 414(1) of the Code that concludes that certain "excess assets" in a defined benefit pension plan may "spinoff" to a profit-sharing plan of the same employer. In a letter of January 16, 1985 (copy attached) the Service in response to a request for general information concluded that a plan sponsor with an overfunded defined benefit pension plan in which assets in the plan are in excess of those required to provide accured benefits for all participants on a termination basis, as stated by the plan's enrolled actuary, may "spinoff some of the excess assets in the defined benefit plan to the Company's profit sharing plan in sufficient amounts to satisfy the Company's 401(k) matching contribution."

The position enunciated in this letter would appear to conflict with certain requirements of the Internal Revenue Code of 1954 (the Code), specifically, section 1.401-2(a) of the Service's regulations. This section represents, in part, the exclusive benefit requirement of the Code which provides that a trust is not qualified under the trust instrument unless it is impossible for any part of the trust corpus or income to be used for, or diverted to purposes other than the exclusive benefit of such employees or their beneficiaries. Moreover, section 1.401-2(a)(3) states that those purposes other than for the exclusive benefit of employees or their beneficiaries includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust. This provision of the Code and the regulations would appear to specifically prohibit the type of diversion sanctioned under the Service opinion letter.

Rev. Rul. 73-534:1973-2 C.B. 132 issued by the Service, concluded that the qualified status of a pension plan that was overfunded is adversely affected by a plan amendment permitting the transfer of surplus funds from such plan to another qualified pension plan of the same employer that was underfunded. This revenue ruling states that "section 1.401-2(b)(1) of the Income Tax Regulations provides that the intent and purpose in section 401(a)(2) of the Code of the phrase 'prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust' is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, any balance remaining in the trust which is due to erroneous actuarial computations during the previous life of the trust. Furthermore, section 1.401-1(a)(3)(iv) of the regulations construes the requirement with respect to nondiversion to mean there must not be any diversion other than for the benefit of the employees and their beneficiaries."

It would appear that provisions of the Code and the regulations would clearly prohibit, under the described facts in the opinion letter and its factual analogy under Rev. Rul. 73-534, the diversion of excess assets in violation of the exclusive benefit rule. Moreover, it is not clear under the information letter whether the same group of employees are covered under the overfunded pension plan and the profit-sharing plan, a concern of the exclusive benefit rule.

The Committee would like to obtain from the Service an explanation of the basis for sanctioning this diversion of plan assets as described in the information letter and whether such a diversion is in contravention of the exclusive benefit rule. Moreover, the Service, as signatory to the Administration "guidelines" on plan asset reversions, has sanctioned the diversion of plan assets to an employer in so-called "spinoff" and "termination reestablishment" overfunded terminations. The transfer of excess plan assets similarly in these devices would appear to represent a diversion of plan assets which would appear to be in conflict with the Code and regulations. For this reason, the Committee would like to obtain an explanation of the statutory authority under which plan assets may be diverted in a manner which seem to conflict with the requirements of the Code and the regulations.

Thank you for your attention to this matter.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR:cu

Enclosure

Washington, DC 20224

Person to Contact
Ms. Marticello
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202-566-4220
Refer Reply to:
OP:E:EP:PA
Date:
JAN 16 1985

Mr. Frederick Rumack
George B. Buck Consulting
Actuaries, Inc.
Two Pennsylvania Plaza
New York, NY 10121

In re: Section 414(1) of the Code

Dear Mr. Rumack:

This letter is in response to your request for general information dated November 28, 1984.

According to the information you supplied, a company maintains a qualified defined benefit plan and a qualified profit sharing plan which contains a 401(k) arrangement. The plan's enrolled actuary states that assets in the defined benefit plan are substantially in excess of those required to provide accrued benefits for all participants on a termination basis (benefits on a termination basis are as described in section 1.414(1)-1(b)(5) of the Income Tax Regulations).

In general, in response to your questions:

(1) the Company may, provided the conditions of section 1.414(1)-1 of the regulations are satisfied, spinoff some of the excess assets in the defined benefit plan to the Company's profit sharing plan in sufficient amounts to satisfy the Company's 401(k) matching contribution.

(2) it is not necessary to provide additional vesting to participants in the defined benefit plan at the time of the transaction nor to purchase annuities from an insurance company.

(3) amounts transferred to the profit sharing plan must be treated for purposes of vesting and withdrawal as any other employer contribution to the plan.

(4) the plan to plan transfer is considered an employer contribution for purposes of section 415 of the Code.

(5) the above-mentioned transaction may not be accomplished unless in the current plan year the employer has sufficient current or accumulated profits to enable him to make a contribution to the profit sharing plan.

(6) the spun off amount is not includible in the employer's income nor is it deductible under section 404 of the Code.

(7) the amount spunoff from the defined benefit plan would affect funding under section 412 of the Code through the impact on the actuarial value of plan assets. In general, the transfer is treated as a loss in the transferor plan and a gain in the transferee plan (if the other plan was another defined benefit plan).

This letter is not a ruling and merely provides general information.

Sincerely yours,

Winfield C. Burley

Winfield C. Burley
Chief, Pension Actuarial Branch

Internal Revenue Service

Assistant Commissioner
(Employee Plans and
Exempt Organizations)

Department of the Treasury

Washington, DC 20224

A-6

FEB 27 1985

The Honorable Edward R. Roybal
Chairman
Select Committee on Aging
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of January 25, 1985, which concerned an IRS information letter dated January 16, 1985. That information letter pertained to the transfer, under section 414(1) of the Internal Revenue Code, by an employer of "excess assets" from an over-funded defined benefit pension plan to a profit-sharing plan maintained by the same employer.

In view of the interest in this matter generated after the issuance of that information letter, IRS, DOL and PBGC have just made the announcement contained in the attached new release. As announced, IRS is reviewing the legal and policy implications of such asset transfers under the Code, and we have written a letter withdrawing the January 16, 1985, information letter.

Upon completion of our review of this matter, we will respond to your concerns and questions.

Sincerely

S. Allen Winborne

Attachment

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224

Media Contact: Tel. (202) 566-4024
Copies: Tel. (202) 566-4054

For Release: 2/21/85

IR-85-19

Washington--The Internal Revenue Service today announced that IRS, the Department of Labor and the Pension Benefit Guaranty Corporation are now reviewing whether a company can obtain the use of surplus assets in a defined benefit pension plan without terminating the plan and without complying with the guidelines on pension asset reversions that the three agencies issued jointly in May 1984. The agencies have recently noted statements suggesting that such transfers were allowable. Specifically, an IRS information letter has been construed as allowing the uninhibited transfer of surplus assets from a defined benefit pension plan to a defined contribution plan and the use of the transferred funds for purposes such as to satisfy the plan sponsor's matching obligation to make contributions under a thrift savings plan.

After the three agencies review the legal and policy implications of asset transfers of this kind under their respective statutes, appropriate guidance will be issued. However, because of the public interest in this subject, and to avoid misunderstandings, the agencies have called attention to the following points:

- The agencies have not in any way abandoned, altered or weakened the May 1984 guidelines.

- Internal Revenue Service information letters are intended to provide general guidance to taxpayers. They do not necessarily deal with every aspect of a transaction or every potentially applicable provision of the Internal Revenue Code. Information letters are not legal authority on which taxpayers may rely.

- A transfer of funds between plans is subject to the requirements of Title I of the Employee Retirement Income Security Act of 1974(ERISA), as well as to those of the Internal Revenue Code. In this connection, plan sponsors should be aware that Section 403(c)(1) of ERISA provides that, with limited exceptions, "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." In other contexts, the Department of Labor has ruled that plan-to-plan asset transfers may violate this section as well as other provisions of Part 4 of Title I of ERISA.

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A-7

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PAUL SCHLEGEL
MINORITY STAFF DIRECTOR

February 14, 1985

The Honorable James A Baker, III
Secretary of the Treasury
U. S. Department of the Treasury
15th and Pennsylvania Ave. N. W.
Washington, D. C. 20224

Dear Secretary Baker:

This is to request your personal review and comment on an Administration policy enunciated in the "Implementation Guidelines" (the Guidelines) on overfunded pension plan terminations and plan asset reversions. I and other members of the House Select Committee on Aging (the Committee) are concerned that the policy outlined in these Guidelines is flawed both legally and as a matter of federal policy. Moreover, we are concerned that this present policy, rather than arresting the termination of overfunded pension plans and the reversion of excess assets has, in fact, succeeded in accelerating these terminations to the benefit of employers and to the detriment of the retirement income security of workers, retirees and their families. A Department of Labor study on overfunded terminations concluded that the difference to workers between an expected real benefit and a terminated nominal benefit could represent approximately 45 percent of the real expected benefit. Simply put, a worker could lose nearly half of his anticipated pension benefit through an overfunded plan termination. (See Department of Labor study on Termination of Sufficient Defined Benefit Plans). Based upon the latest information furnished by the Pension Benefit Guaranty Corporation as of January 31, 1985, 381 employers have received approximately $3.5 billion in former plan assets through overfunded plan terminations over the last five years. Presently, over $2 billion in pending requests covering over 200,000 workers are awaiting approval. Over 450,000 employees have been affected, and the trend of overfunded plan terminations and reversions and the loss of retirement income security continues unabated. (See attachment A - PBGC Termination lists). I respectfully request that upon your examination of these Guidelines, you recommend that the policy of the Guidelines be appropriately changed to meet the requirements of law and to better insure the retirement income security of our Nation's workers, retirees and their families.

The Committee's concern with this issue is unswerving. The Committee has conducted two hearings on the threat to retirement income security posed by "plan asset raids" of employers who terminate overfunded pension plans to recover excess assets. (See attachment B - Pension Funding Problems, June 7, 1982, Comm. Pub. No. 97-355 and Pension Asset Raids, September 28, 1983, Comm. Pub. No. 98-438). This Committee has written extensively concerning this issue to the

U. S. Department of Labor, the U. S. Treasury Department, the Internal Revenue Service and the Pension Benefit Guaranty Corporation, the federal agencies (the Agencies) charged with responsibility for administering and enforcing the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1954 (the Code).

The Committee has expressed concern that, in general, overfunded terminations and subsequent reversions of excess plan assets are conducted by employers to obtain financing for corporate mergers and acquisitions, provide for the entrenchment of present corporate managements, improve the balance sheet of financially troubled corporations or provide a quick capital infusion for corporations to conduct other business activities. Such activities are typically detrimental to the interests of plan participants and beneficiaries through the loss of retirement income security due to the termination of the overfunded pension plan by the employer.

This Committee, through its correspondence and hearings over a three and half year period, has urged a more aggressive policy by the Internal Revenue Service (the Service) and an enforcement of those provisions of the Code which would presumably curtail and restrict certain overfunded terminations and asset reversions to employers. These urgings have unfortunately not resulted in the construction of a policy by the Agencies which effectively protects and preserves the interests of workers, retirees and the Nation's private pension system.

After exhaustive communications over a period of two and one half years by this Committee and by other members of the Congress to prod the Administration into action, in May, 1984, the Agencies announced the release of certain Implementation Guidelines on overfunded pension plan terminations. The announcement of these Guidelines, rather than representing a strong policy statement interdicting overfunded terminations, has apparently spawned a noticeable increase in such terminations with a commensurate loss of benefit security to workers and retirees. However flawed a policy may be, it should still observe the rule of law as enunciated by the Congress through ERISA and the Code. The authority of the Agencies to sanction so-called "spinoff" and "reestablishment" terminations under the Administration Guidelines is highly problematic and may, with respect to certain requirements within the Guidelines, simply conflict with existing statutory provisions of ERISA and the Code.

It was clear prior to the issuance of these Guidelines that several of the responsible Agencies and their officials had serious reservations regarding the legality of permitting spinoff and reestablishment terminations. Specifically, the the Service in a letter of December 7, 1983 from S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations, to the Pension The

Benefit Guaranty Corporation (the Corporation stated that, "...the principal affect of the termination/ reestablishment techniques is that the employer is able to obtain plan assets that would not otherwise have been available while continuing a qualified defined benefit plan." (See attachment C). The letter further states that, "...In a recent meeting of the IRS-Treasury Policy Committee attended by the Commissioner, the Assistant and Deputy Assistant Secretaries for Tax Policy of Treasury, the Associate Chief Counsel (Technical) for IRS and me, a decision was reached on the Internal Revenue Service Policy in this area and the courses of action that are to be taken in an attempt to prevent the abusive recovery of excess assets" (emphasis added). The letter then proceeds to describe the imposition of a substance-over-form doctrine and an actuarial error theory to control spinoff and reestablishment terminations. The letter concludes by indicating that "...Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately." Draft regulations were in fact prepared but never issued and subsequently the Guidelines legitimized spinoff and reestablishment terminations in complete derogation to this earlier announced position.

Similarly, in a letter of July 25, 1983 from Edwin Jones, then Executive Director of the Corporation to the Treasury Department, the Corporation espoused its concerns regarding spinoff terminations. That letter, in pertinent part stated: (See attachment D)

> Consider the reality of the purported creation of a separate plan for retired lives. By "spinning off" active lives, all that the employer has done is execute another plan document with the same provisions as the existing plan document but made applicable only to active lives. Presumably, the employer also made a formal transfer of assets and liabilities attributable to active lives. At this point, any resemblance to the existence of a separate plan for retired lives ceases. What exists are two plan documents and funds purportedly applicable to separate groups. But the retired lives "division" has none of the indicia of a separate plan. It is to terminate immediately. It is a creature fleetingly created, intended to smooth the path to a termination which, without this creature, would not be recognized by PBGC since under Title IV of ERISA a "partial" termination is not an insurable event. Contributions will never be made to the so-called "retired lives plan." It will never cover any active participants. This so-called separate plan is completely lacking in permanence. The bottom line is that the arrangement amounts to no more than the continuance of payment of pension benefits to retirees and provision for benefits for other non-active lives, with the funding of all of these

> benefits through the purchase of annuities in an ongoing plan. This is the reality of the situation when one cuts through the trappings. In a sufficient plan with excess assets, annuities are purchased to the extent of the full accrued benefits of the non-active lives. In the case of an insufficient plan, the benefits payable under the plan prior to the "carve-out" arrangement would be reduced to the level of PBGC guaranteed benefits if PBGC were to accept the termination of the "carved-out" plan. (emphasis added).

The letter further notes that the Corporation's liabilities could be increased if there is an eventual termination of an overfunded plan in a spinoff and concludes that, "...We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and in many others is apparent" (emphasis added).

Although the Corporation's letter unequivocally states the nature of the threat represented by the sanctioning of a spinoff termination subsequently, the Corporation under a new Executive Director, was a signatory and principal supporter of spinoff terminations under the Administration's Guidelines. It is unclear to myself and other members of the Select Committee how the seminal policy concerns and legal objections voiced by these Agencies could be so blithely turned aside in sanctioning this Administration's approach to spinoff and reestablishment terminations. At the very least, it is clear that the Agencies were aware of the substantive and legal implications raised by these techniques. At the worst, it appears that the interests of pension plan participants and beneficiaries, statutorially delineated under ERISA and the Code, may have been sacrificed in an expedient rush to assuage certain employers and their representatives who sought to implement these techniques.

The scenario of unusual policy development concerning overfunded terminations by the Agencies does not, however, end with the issuance of the Administration's Guidelines. In a recent information letter of January 16, 1985 to George Buck Consulting Actuaries, Inc., the Service concludes that certain "excess assets" in a defined benefit pension plan may "spinoff" to a profit-sharing plan of the same employer. Specifically, the Service concluded that a plan sponsor with an overfunded defined benefit pension plan in which assets in the plan are in excess of those required to provide accrued benefits for all participants on a termination basis, as stated by the plan's enrolled actuary, may "spinoff some of the excess assets in a defined benefit plan to the Company's profit sharing plan in sufficient amounts to satisfy the Company's 401(k) matching contribution.

The Committee has written the Service in a letter of January 25, 1985, expressing concern regarding the position enunciated in that letter (See attachment E). Specifically, the position of this information letter would appear to conflict with the exclusive benefit requirements of the Code and would be inconsistent with the policy and requirements of the Guidelines, which would be presumably controlling under the factual circumstances provided in the information letter.

It would appear that the Department of Labor and the Corporation were not consulted prior to the issuance of this letter to determine whether the provisions of Title I and Title IV, respectively, would be applicable to the factual circumstance and opinion rendered by the Service. It would also appear based upon the Agency letters cited in this letter and other Agency memoranda furnished to the Committee that this Administration has and is experiencing some difficulty in maintaining a consistent policy and legal treatment of issues arising from overfunded terminations and asset reversions. Further policy conflict may more recently be demonstrated by the Executive Director of the Corporation publicly voicing opposition to the Treasury Department's proposal to impose a 10% excise tax on asset reversions. What is clear is that as this scenario of shifting policy positions unfolds, more and more workers and retirees are being deprived of their retirement security through overfunded terminations and reversions to employers. Moreover, certain of the requirements and techniques pertaining to overfunded terminations contained in the Guidelines would appear to be in complete derogation of provisions of ERISA and the Code. Such an approach simply cannot be tolerated. For this reason, I previously introduced and will reintroduce legislation to the Congress which would apply rational controls on plan asset reversions. (See attachment F, H.R. 6404, The Plan Termination and Reversion Control Act of 1984, 98th Congress and accompanying statement). However, the introduction of this legislation does not absolve the flawed and legally unsubstantiated policy which is reflected in this Administration's Guidelines on overfunded terminations and plan asset reversions.

With this background, the Committee is concerned that the statutory authority of the Agencies and, in this instance, the Service to promulgate certain of the requirements contained in the Guidelines is highly questionable. For this reason, the Committee would like to obtain explanations to the following questions.

1. What, in the opinion of the Service, is the legal status of the Guidelines issued on behalf of the Administration? Specifically, do these Guidelines carry the force and effect of federal law or are they guidelines for the internal processing of determinations requests concerning plan terminations by the Service? If, for example, in the instance of a so-called spinoff termination, the employer does not observe the requirement of section 4 of the Guidelines and does not

purchase annuity contracts which represent irrevocable commitments for the benefit of each participant, would such a failure constitute a violation of the Guidelines? Would the failure to annuitize violate provisions of the Code? Would such a failure and the resulting spinoff of plan assets constitute a diversion of plan assets for a purpose other than for the exclusive benefit of plan participants and beneficiaries? If such a spinoff, absent annuitization, does constitute a violation of the exclusive benefit rule of the Code, how do the conditions included in the Guidelines, including annuitization cure or otherwise relieve this diversion of plan assets in violation of the exclusive benefit rule of the Code? Please be specific in your response citing appropriate Code and other legal authority for your answer.

2. With respect to a so-called spinoff termination under the Guidelines, Code section 401(a) and section 1.401-1(b)(2) of the regulations (See also Rev. Rul. 69-24, 1969-1CB 110 and Rev. Rul. 69-25, 1969-1 C.B 113) provide that assets of a qualified plan may not be removed from the trust, other than for appropriate exceptions (i.e. benefit payments, etc.) while the plan is in existence. In substance, a spinoff termination, with the creation of presumably two comparable plans, one covering retirees and containing "excess assets" and the other covering active participants, results in the diversion of plan assets from an existing qualified plan to another qualified plan of the same plan sponsor. It has long been the practice and position of the Service under the exclusive benefit provisions of the Code 2 that such a diversion or transfer of assets as represented by a spinoff termination would adversly affect the tax qualified status of a plan. With this background, under what statutory authority does the Service sanction the removal of plan assets from a plan in a spinoff termination in apparent contravention of the exclusive benefit rule of the Code. Will the Service promulgate any regulations or issue any other advisory information specifying the statutory basis for such a diversion of assets? Please include references to relevant regulations, revenue rulings or other interpretative bulletins which constitute the basis for such authority. Prior to the issuance of the Administration's Guidelines on May 24, 1984, under provisions of the Code, regulations and revenue rulings of the Service, were "spinoff" and "reestablishment" terminations prohibited after the passage of ERISA, including Title II of the ERISA? Please cite relevant Code and regulatory authority which controlled and characterized these techniques of plan termination. Prior to the passage of ERISA, the creation of a "comparable" plan after the termination of a similar defined benefit plan of an employer was prohibited under regulations

of the Service. What was the specific Code and regulatory authority for this prohibition on the creation of a "comparable" plan and how was this prohibition altered by the passage of ERISA?

3. Under section 401 of the Code and section 1.401-2(b) of the regulations and Rev. Rul. 83-52, an employer may only recover excess assets following the termination of a plan. Moreover, such excess assets may revert only if those amounts were the result of "actuarial error". Since the excess assets arising from any spinoff termination would result from the employer's decision to terminate the plan, how would such remaining assets in the plan, after satisfaction of liabilities (i.e. benefits to plan participants) be the result of "erroneous actuarial error"?

4. Are the requirements of the Code and regulations applicable to the "retired lives plan", (i.e. the plan containing retired participants and excess assets) after a spinoff termination and, if so, are those provisions of the Code and the regulations which require that a plan be established with an intent to create a permanent program of benefits violated by the immediate termination of the retired lives plan after the spinoff has been accomplished? Does the segregation of excess assets and retired participants in the retired lives plan, which is immediately terminated after the spinoff, create a potential violation of the exclusive benefit rule of the Code? It should be noted that the retired lives plan typically never covers active plan participants. Indeed, if the steps in the transaction were reversed and a spinoff of non-active or retired participants were formulated into a successor plan, the failure to satisfy the permanency requirements of the Code would be patently obvious. Please comment on this possible formulation of a spinoff arrangement and its implications with respect to the permanency and exclusive benefit requirements of the Code?

5. Does the "annuitization requirement" of the Guidelines cover only the "accrued benefits" of each participant, as that term is defined in regulation section 1.411(a)-7(a)(1)(ii), or must the annuities purchased also cover ancillary benefits provided under the plan, such as subsidized early retirement benefits, pre-retirement death benefits, payment of medical expenses, disability benefits, and life insurance benefits payable as a lump sum?

6. With respect to spinoff terminations, in particular, and other overfunded terminations in general, what are the "accrued benefits"

of plan participants under section 301 of the Retirement Equity Act (REA) and will the provisions of REA generally have the affect of reducing those amounts which may revert to an employer?

7. Section 411(a)(10) of the Code requires that any employee having five or more years of service may elect to be fully vested in their future accrued benefits. Under the Guidelines and with respect to spinoff terminations, would the "termination" under a spinoff constitute a change in the vesting schedule for purposes of Code section 411(a)(10) requiring an election for participants?

8. Under the requirements of the Guidelines, under what specific Code authority does the Service constrain the immediate vesting upon termination in spinoff arrangements of non-vested participants and with respect to any termination, the immediate vesting of vested and non-vested participants?

9. Under what Code or other statutory authority does the Service constrain, under the Guidelines, that only insurance annuity contracts be utilized to secure benefit payments to plan participants in a spinoff and reestablishment termination?

10 With respect to the requirement in the Guidelines that the summary plan description (SPD) disclose that the employer reserve the right to terminate the plan, and in coordination with the Title I requirements of SPD disclosure administered by the U. S. Department of Labor, if it is found that an employer has not properly disclosed the entitlement of the employer to terminate the plan in the SPD, will the Service remove or otherwise restrict the tax qualified status of such a plan prior to or following their application for determination with respect to the termination of the plan? If not, what sanction would be applied under such a failure and what agency would impose such a sanction?

11. Typically, excess assets consist of both employer contributions and untaxed appreciation on plan assets. Amounts attributable to contributions would be subject to the tax benefit rule of the Service. Would the tax benefit rule also apply to those amounts which represent untaxed appreciation on plan assets or is some other tax treatment appropriate for these amounts?

12. Under the Guidelines an employer may use a spinoff or termination reestablishment termination wherein a presumably comparable

"successor" plan is established. What is a "successor" plan for purposes of these guidelines and under what Code authority does the Service seek to define its existence?

13. Under certain situations in which the successor plan of an employer is heavily populated with older employees, a loss of benefit security may occur where an older participant or participants with many years of service and where future accruals under a spinoff or termination reestablishment successor do not keep pace with actual benefit accruals. In such a situation the Corporation or participants, or both may suffer in the event the plan were to terminate. Does the Service view this potential situation as a problem and will it propose additional safeguards to protect plan participants from a possible loss of benefit security? Does the removal of excess assets in a spinoff or reestablishment termination basically conflict with or violate the minimum funding requirements of Title I and Title II of ERISA?

14. Does the Service feel that there are any opportunities for federal tax abuse with respect to the termination of an overfunded defined benefit pension plan? Specifically, is the Service concerned that an employer may use a qualified employee benefit plan to accumulate, tax free, amounts of income which may be extracted at any time through voluntary plan termination wherein the specific purpose in providing tax exempt status for the trust was to encourage employers to provide a permanent program of benefits to provide retirement security to workers?

15. Is the Service concerned that through the Administration's sanctioning of spinoff and termination reestablishment terminations that an employer may be able to successfully evade the full funding limits of the Code by removing assets at a time when the plan is nearing its full funding limits and then continuing to fund on the basis of benefits calculated by reference to all past service?

16. Section 6 of the Guidelines indicates that an employer may not engage in either a reestablishment or spinoff termination transaction involving a reversion of assets any earlier than 15 years following any such transaction. What Code provision authorizes this limitation on the frequency of these transactions and why was 15 years selected as the limitation? Generally, over what period must a plan be in existence to meet the permanency requirements of the Code?

17. The Guidelines do not address the question of funding deficiency waivers with respect to so-called "successors" plans following a spinoff or reestablishment termination. Will the Service apply the same rules and policy for the granting of funding waivers to these "successor" plans or will special rules be promulgated to treat their situation?

I have instructed my staff that this letter be embargoed from any media or other public dissemination. It is my hope that this will afford you an unfettered opportunity to thoroughly review and consider the concerns expressed in this letter.

I and other members of the Committee seek an expeditious response to these concerns. Your responses will ultimately assist me and other members of not only the Select Committee, but also the members and staff of the Appropriations Committee, Subcommittee on Treasury Postal Service, General Government, which I chair. Thank you for your consideration.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR:eu
Attachments Enclosed

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

MAR 25 1985

A-8

Dear Mr. Roybal:

This is in response to your letter of February 14, 1985, requesting that the Treasury Department respond to a series of seventeen specific questions relating to the Administration's Guidelines, issued on May 24, 1984, on asset reversions from terminating defined benefit plans. (A copy of your letter is enclosed.)

You question whether the Guidelines fully implement existing law and represent appropriate retirement policy. In addition, you express concern that the Guidelines may have accelerated the termination of defined benefit plans "to the benefit of employers and to the detriment of the retirement income security of workers, retirees and their families."

Let me begin by assuring you that this Administration is committed to assuring that qualified defined benefit plans established by employers actually deliver the promised retirement benefits to employees and their beneficiaries. The private pension system plays an integral role in providing employees with meaningful levels of retirement income, and the continued viability of this system is one of the Administration's highest priorities. Indeed, it was in this spirit that the Administration developed and adopted the Guidelines.

Background

It has long been the law that an employer may not receive funds from an ongoing defined benefit plan even if the funds are in excess of the amount necessary to provide all benefits accrued under the plan. In particular, section 401(a) of the Code requires that a qualified plan of an employer be for the "exclusive benefit" of the employer's employees and their beneficiaries. In addition, section 401(a)(2) provides that it must be impossible, at any time prior to the satisfaction of all liabilities with respect to the employer's employees and their beneficiaries under the plan, for any part of a qualified plan's assets to be used for, or diverted to, purposes other than for the exclusive benefit of the employees and their beneficiaries.

It is similarly true, however, that the private pension system is a voluntary system. Within certain limits, an employer may voluntarily establish a qualified plan and may voluntarily terminate its plan as it desires. The law does not require that additional benefits continue to accrue to employees for years of service after plan termination, even though this means that employees do not receive the benefits at retirement that they would have received if the plan had not been terminated.

In 1943, Congress rejected proposals to extend to terminating defined benefit plans the rule against asset reversions from ongoing plans; the proposals would have made employer contributions to qualified plans irrevocable. Instead, Congress concluded it was appropriate to permit employers to receive funds from a terminating defined benefit plan if all benefits accrued by participants under the plan as of the date of termination, both vested and unvested benefits, were fully funded. This rule was and continues to be fully consistent with the fundamental nature of qualified plans as voluntary undertakings of employers.

In the Retirement Equity Act of 1984 (REA), Congress again considered the question of participants' benefits after plan termination. By amending section 411(d)(6) of the Code, section 301 of REA clarified that benefits (including optional benefit forms, early retirement benefits, and retirement-type subsidies) accrued as of the date of termination may not be eliminated or reduced, both for participants who had satisfied all of the conditions for such benefits as of the termination and for participants who had not, as of the termination, satisfied all of such conditions. The logical foundation for this provision is entirely consistent with and, indeed, is premised upon the notion that qualified plans are voluntarily maintained and may be voluntarily terminated by employers.

There are four basic situations involving terminations of defined benefit plans: (1) the termination of the defined benefit plan and no establishment of a successor plan; (2) the termination of the defined benefit plan and the establishment of a new defined contribution plan; (3) the termination of the defined benefit plan and the establishment of a new defined benefit plan (reestablishment transaction); and (4) the spinoff of the defined benefit plan into two plans, the termination of one of the two spunoff plans, and the continuation of the other spunoff plan (spinoff transaction).

The first two of these termination situations involve the departure of the employer from the defined benefit plan system. Because of the voluntary nature of the system, the ERISA agencies (the Departments of Treasury and of Labor and the Pension Benefit Guaranty Corporation (PBGC)) are unable to implement rules preventing such departures. However, these agencies are charged with assuring that, as a condition of plan termination, employers and plans satisfy certain requirements. In addition to compliance with various qualification requirements (e.g., nondiscrimination), the law also prohibits plan assets from reverting to the employer before adequate provision is made for all benefits accrued under the plan as of the termination--both vested and unvested benefits. This requirement is generally satisfied by the distribution of benefits or the purchase and distribution of contracts guaranteed by insurance companies.

The reestablishment and spinoff transactions, however, involve both the termination of a plan and the continuation of the employer in the defined benefit system. Thus, where assets revert to the employer upon formal termination of a defined benefit plan as part of either of these transactions, it is arguable that the employer has, in effect, received assets from an ongoing defined benefit plan. This is the case even though the plan from which the assets are reverting is formally terminated.

It came to the attention of the ERISA agencies that employers were undertaking reestablishment and spinoff transactions in order to gain access to plan assets that were not otherwise accessible. The agencies were concerned first that the transactions might seriously reduce the security of participants' benefits that had been accrued prior to the termination or spinoff. In addition, the agencies were concerned that, relative to the reestablishment transaction, the spinoff transaction permitted the employer to gain access to plan assets without satisfying the formal requirements of plan termination and thus left continuing plan participants with significantly less benefit security than they would have had under a reestablishment transaction.

After preliminary examination, the Treasury Department and the Internal Revenue Service proposed to prohibit reestablishment and spinoff transactions by recasting them as substantively nothing more than withdrawals of assets from continuing plans. This initial position was reflected in a letter from S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations, to the PBGC (December 7, 1983). After more in-depth consultation with the other ERISA agencies, however, we realized that, aside from various administrative difficulties, full application of this approach to support the conclusions that there had been no plan termination and thus could be no reversion would in fact discourage employers from participating in the defined benefit system. We thus concluded that, in many situations, the primary victims of vigorous enforcement of this approach would be the employees of employers that terminated defined benefit plans without establishing new defined benefit plans.

On the basis of these further deliberations, the Administration issued the Guidelines in May 1984. The objective was to balance the interests of participants and employers by preventing employers from gaining access to the assets of ongoing defined benefit plans unless participants' accrued benefits are fully protected, while not discouraging employers from maintaining (both in the first instance and after a plan termination) or properly funding defined benefit plans. Of course, one may argue about the balance struck by the Guidelines, both as a policy and a legal matter--on this point, both the Service and the PBGC are already involved in litigation in which employers are challenging the Guidelines as being too restrictive and without legal basis--but it is undoubtedly the case that a too aggressive position would discourage defined benefit plans. The ERISA agencies firmly believe, however, that the Guidelines represent a reasonable administrative solution within the confines of existing law to this problem.

The Guidelines extend to spinoff transactions the requirements that apply to all plan terminations, including terminations occurring as part of reestablishment transactions. The Guidelines aim at providing substantive parity between spinoff transactions and all other terminations by requiring full vesting and annuitization of all benefits accrued as of the time of termination and formal notice to all participants of the proposed transaction. Also, the Guidelines extend additional security to plan participants in the continuing defined benefit plans under these transactions by requiring that certain amortization adjustments be made to the funding methods of such plans. Finally, the Guidelines implement the plan permanency requirement by specifying that reestablishment and spinoff transactions may not be undertaken more than once every fifteen years.

Specific Responses to Questions in February 14, 1985 Letter:

Answer 1:

The Guidelines are the ERISA agencies' interpretation of the respective statutes that they administer. They reflect the agencies' enforcement policy under ERISA that reversions are permitted only if the purposes and requirements of ERISA are satisfied. The Guidelines are used by the Service in the processing of determination letter requests and in examining terminating defined benefit plans involving asset reversions. They are not substantive rules under the Administrative Procedure Act (5 U.S.C. 553).

The ERISA agencies believe that the requirements of the Guidelines provide participants with the necessary benefit protections where defined benefit plans are terminating. Thus, the Service generally will not recognize as bona fide a plan termination occurring as part of a reestablishment or spinoff transaction unless the Guidelines are satisfied. If the Guidelines are not satisfied, any reversion of plan assets to the employers will be treated by the ERISA agencies as a diversion of assets for a purpose other than the exclusive benefit of employees and their beneficiaries in violation of section 401(a)(2) of the Code and section 1.401-2(a) of the regulations. This treatment is subject to judicial review, however, as the final interpretation of those provisions of the Code and regulations rests with the courts. Consequently, the terminating and continuing plans may be disqualified and participants may have rights to sue under Title I of ERISA. If the Guidelines are satisfied, however, it is the view of the ERISA agencies that the interests of participants are adequately protected, and thus in such cases the Service generally will not raise the exclusive benefit issue solely because plan assets revert to the employer.

Answer 2:

Before ERISA, the Service did not preclude an employer from terminating a defined benefit plan and establishing a successor defined benefit plan, including a "comparable" plan. Section 1.401-6 of the regulations was promulgated under pre-ERISA section 401(a)(7) of the Code, which provided for the vesting of otherwise unvested benefits (to the extent funds were available) on a termination or complete discontinuance of contributions. (The regulations extended the additional vesting requirement to cover partial plan terminations.) The reason for the regulatory adoption of the "comparable" plan concept was to provide relief from the vesting requirement of section 401(a)(7) where a "comparable" plan was adopted. Pre-ERISA law thus did not preclude the establishment of a comparable plan.

ERISA made several changes in this area. It moved the additional vesting rule of section 401(a)(7) to section 411(d)(3). Also, it provided for additional vesting in "partial terminations." Furthermore, it eliminated the concept of a "complete discontinuance of contributions" for pension plans subject to the minimum funding standards. In section 1.411(d)-2 of the regulations, promulgated under section 411(d)(3), the relief that had been provided under the pre-ERISA regulations for terminations followed by "comparable" plans was not continued, so that full vesting is required on a termination, including a partial termination, even though a comparable plan is established.

In addition, ERISA added sections 401(a)(12) and 414(l) to the Code to provide participants with protection where there is a merger or consolidation of plans or a transfer of assets or liabilities between plans. These sections require, in relevant part, that a plan will not be qualified unless, in connection with a transfer of assets or liabilities, each participant has benefits (calculated on a termination basis) under the plan immediately after the transfer which are equal to or greater than the benefits the participant had (on a termination basis) immediately before the transfer. More specifically, section 1.411(l)-1(n) of the regulations provides that section 414(l) is satisfied if (i) the accrued benefits of each participant under the defined benefit plan are allocated to only one of the spunoff plans, and (ii) the value of the assets allocated to each of the spunoff plans is not less than the sum of the present value of the benefits (calculated on a termination basis) in the plan before the spinoff for all participants in that spunoff plan. Because section 414(l) provides that benefits are to be calculated on a termination basis, rather than on a going concern basis, an employer that is undertaking to spin off a defined benefit plan may be free to allocate substantial assets to either of the spunoff plans.

Under pre-ERISA, post-ERISA, and post-Guidelines law, the Service has uniformly precluded asset reversions from defined benefit plans that were not terminating. However, the substance-over-form doctrine has rarely, if ever, been applied in the qualified plan area. Thus, the Service has routinely approved terminations and reversions occurring as part of reestablishment and spinoff transactions. However, until recently, it was not apparent that these transactions occurred with any frequency. When they became prevalent, the ERISA agencies undertook to formulate an appropriate response and, as a result, the Guidelines were issued.

The reestablishment and spinoff transactions generally result in the termination of a defined benefit plan containing excess assets and the establishment, or continuation, of another defined benefit plan (including a plan identical to the terminated plan). It is arguable that the Service could attack these transactions by applying the substance-over-form doctrine. Under this doctrine, if it could be demonstrated that in undertaking the transaction the employer's intent was in effect to obtain assets from an ongoing defined benefit plan, the Service could conclude that an actual plan termination has not occurred and any reversion is an impermissible diversion of plan assets under the exclusive benefit rule. Thus, full application of the substance-over-form doctrine could result in the disqualification of the defined benefit plans involved in the transaction.

Full application of the substance-over-form doctrine, however, could have serious adverse effects on the interests of plan participants and would not constitute sound pension policy. For example, it is clear that an employer may gain access to excess plan assets if the employer simply terminates its defined benefit plan and either fails to establish another plan or establishes a defined contribution plan. Also, full application could discourage employers from conservatively funding their defined benefit plans. Each of these employer responses to full application of the substance-over-form doctrine could seriously harm plan participants. The ERISA agencies thus concluded that, within the confines of existing administrative authority, the conditions contained in the Guidelines would most effectively protect the interests of plan participants generally.

Answer 3:

Under section 1.401-2(b)(1) of the regulations, an employer may recover upon the termination of an overfunded defined benefit plan any balance remaining in the plan which is due to erroneous actuarial computations during the previous life of the plan. Due to other requirements, such as prohibitions against decreases in plan benefits (see section 411(d)(6) of the Code), it generally is the case that all excess assets upon plan termination result from actuarial error.

In a typical spinoff transaction, an employer splits an overfunded defined benefit plan into two spunoff defined benefit plans, one for active employees and one covering retired employees. The employer allocates to the active employees' plan assets equal to the present value of the active employees' benefits, in accordance with section 414(l) of the Code. The employer then allocates all other plan assets, including the excess assets, to the retired employees' plan, leaving it overfunded. Upon termination of the retired employees' plan, the excess assets revert to the employer.

If the plan termination had occurred before the spinoff, the excess assets would have been attributable to erroneous actuarial computations. Thus, the surplus was neither created nor enhanced by the spinoff. As long as the Guidelines are satisfied, the excess assets, which remain the result of actuarial error, may revert to the employer.

Answer 4:

The permanency rule of section 1.401-1(b)(2) of the regulations requires that, at the time of plan establishment, the employer intend that the plan be a permanent program. The rule does not require that a plan in fact never terminate. Nor does it require that, as of the date of a merger, spinoff, or plan amendment, the employer intend the plan to be permanent. Thus, undertaking a spinoff transaction with a defined benefit plan that has been maintained for a long period no more violates the permanency rule than does amending an overfunded defined benefit plan to liberalize benefits immediately before termination. In accordance with Rev. Rul. 80-229, any such liberalization of benefits may provide that surplus assets will be used for benefits for current plan participants.

Answer 5:

Under section 401(a)(2) of the Code and section 1.401-2(b)(2) of the regulations, excess assets may not be returned to the employer until all liabilities to participants and beneficiaries have been satisfied. All accrued and other plan benefits that may not be decreased or eliminated by plan amendment under the rules of section 411(d)(6), as amended by the Retirement Equity Act, must be provided--either through the distribution of plan assets or under a contract with an insurance company--before plan assets may revert to the employer. Thus, for example, the Guidelines require that the value of all subsidized early retirement benefits accrued under the plan as of the time of termination be guaranteed under a contract with an nsurance company. This includes any early retirement benefits accrued by participants who have not, at the time of the termination, yet satisfied the conditions for receiving the benefits, but who may subsequently satisfy such conditions. See Rev. Rul. 85-6.

Answer 6:

Section 301 of the Retirement Equity Act (REA) amended section 411(d)(6) of the Code to make it clear that, except in certain cases not here relevant, the accrued benefit of a participant may not be reduced or eliminated by plan amendment. As amended, section 411(d)(6) makes it clear that an early retirement benefit, a retirement-type subsidy, and optional forms of benefits are generally to be treated as accrued benefits that may not be reduced or eliminated. With respect to the term "retirement-type subsidy," the Senate Finance Committee Report (August 6, 1984), which is the governing report on REA, states as follows:

> The bill provides that the term "retirement-type subsidy" is to be defined by Treasury regulations. The committee intends that under these regulations, a subsidy that continues after retirement is generally to be considered a retirement-type subsidy. The committee expects, however, that a qualified disability benefit, a medical benefit, a social security supplement, a death benefit (including life insurance), or a plant shutdown benefit (that does not continue after retirement) will not be considered a retirement-type subsidy.

The Senate Finance Committee Report also discussed the application of section 411(d)(6) to terminated plans, as follows:

> The bill does not provide an exception to the prohibition against reduction of benefits or elimination of benefit options in the case of a terminated plan. Accordingly, a plan is not to be considered to have satisfied all of its liabilities to participants and beneficiaries until it has provided for the payment of contingent liabilities with respect to a participant who, after the date of the termination of a plan, meets the requirements for a subsidized benefit. . . . The committee recognizes

> that there is a potential for abuses with respect to plan terminations under the provision. If abuses of this type develop, further legislation may be necessary in order to resolve these problems, if administrative solutions are inadequate.

Revenue Ruling 85-6 (issued February 4, 1985) effectively implements the application of section 411(d)(6) of the Code to subsidized early retirement benefits upon the termination of a defined benefit plan.

With respect to all plan terminations, including terminations occurring as part of reestablishment and spinoff transactions, contingent accrued benefits (including subsidized early retirement benefits) must be provided, either through the distribution of plan assets or under a contract with an insurance company. It is inevitable that this requirement will reduce the size of reversions.

Answers 7 and 8:

Section 411(a)(10) of the Code and section 1.411(a)-8 of the regulations require, in part, that upon an amendment to a plan's vesting schedule, participants with five or more years of service must be allowed to elect to remain covered under the pre-amendment vesting schedule. Section 411(d)(3) provides, in part, that a plan must provide, upon termination of the plan, that all participants' accrued benefits become nonforfeitable to the extent that funds are available under the plan to provide for such otherwise unvested benefits.

In a spinoff transaction, the termination of the retired employees' plan would not constitute a change in the vesting schedule for purposes of section 411(a)(10). However, section 411(d)(3) would require that participants in the terminated plan become fully vested in their otherwise unvested benefits to the extent that funds are available under the plan. Under the Guidelines, which are aimed in part at providing substantive parity between reestablishment and spinoff transactions, before any assets may revert to the employer, participants in the ongoing defined benefit plan also must become fully vested in their otherwise unvested benefits. If such vesting does not occur, the Service will apply the substance-over-form doctrine to disqualify the plans.

Answer 9:

Under section 401(a)(2) of the Code, assets may revert to the employer only after all plan liabilities--both fixed and contingent liabilities--have been satisfied. Satisfaction of plan liabilities requires either the distribution of assets or the annuitization of benefits under a contract with an insurance company. Also, PBGC regulations (29 CFR 2617.4) require, with limited exceptions not here relevant, that upon plan termination any benefits payable as an annuity under the plan be provided through the purchase of an annuity contract from an insurer (or by the PBGC in appropriate situations).

These annuitization requirements apply to all participants in terminating plans, including plans that terminate as part of reestablishment and spinoff transactions. As part of their objective to assure substantive parity between reestablishment and spinoff transactions, the Guidelines also provide that, if the substance-over-form doctrine is not to be applied, benefits for participants in the ongoing defined benefit plan in the spinoff transaction must be annuitized.

Answer 10:

The Guidelines do not specifically require that the summary plan description (SPD) disclose the employer's right to terminate its defined benefit plan and receive a reversion of excess assets. It is our understanding, however, that the Department of Labor has issued a Technical Bulletin, 84-1, imposing such a requirement.

Compliance with the SPD requirements of Title I of ERISA is not a condition of tax-qualification and therefore a failure to satisfy such requirements will not jeopardize a plan's status under the tax laws. As to the appropriate Title I sanctions, we defer to the Department of Labor.

Answer 11:

All excess assets reverting to an employer upon termination of a defined benefit plan would be included in the employer's income. There would be no distinction between the portion of the reversion attributable to employer contributions and the portion attributable to previously untaxed income or appreciation of plan assets.

Answer 12:

The reference in the Guidelines to "successor plan" relates to the PBGC's determination of ERISA's Title IV guarantees of participants' benefits. We defer to the PBGC for the proper interpretation of the term "successor plan."

Answer 13:

The ERISA agencies were indeed concerned that reestablishment and spinoff transactions would weaken the minimum funding standards, particularly with respect to plans "heavily populated with older employees." Thus, the Guidelines require that such plans adopt shorter funding amortization periods in order to increase the security of benefits accrued after the termination. We believe that this requirement properly addresses the potential weakening of the minimum funding standards, while at the same time not discouraging employers from maintaining defined benefit plans.

Answer 14:

We recognize that some employers may intentionally use defined benefit plans to accumulate assets, on a tax-favored basis, for purposes other than the provision of retirement benefits to employees. Even employers that have not intentionally used defined benefit plans to accumulate tax-favored nonretirement funds may gain the benefits of such tax-favored treatment by receiving excess assets upon plan termination. In either case, an employer may have made contributions in profitable years and received the reversion in years with significant tax losses, thereby making the reversion effectively tax free.

The tax-favored treatment of qualified plans is aimed at the provision of meaningful retirement benefits to employees. We believe that, regardless of whether an employer has intentionally used its defined benefit plan to accumulate tax-favored assets for nonretirement purposes, it is appropriate to recapture some portion of the tax benefits provided with respect to any assets reverting to the employer. In this regard, as part of Treasury's Tax Reform Report to the President, we proposed that all assets reverting to an employer upon plan termination be subject to an additional tax of 10 percent; such tax would be nondeductible and could not be offset by deductions or credits. Given the substantial tax advantages provided to qualified plans, we think it is proper to assure that there is a real tax cost to asset reversions. In addition, the proposal was based on our view that such an additional tax would discourage employers from intentionally using defined benefit plans to accumulate funds for nonretirement purposes without also discouraging the maintenance or sound funding of such plans. Currently, we are consulting with the other ERISA agencies and reexamining this proposal as part of our comprehensive review of the entire Tax Reform Report.

Answer 15:

In developing the Guidelines, we considered the relationship between reestablishment and spinoff transactions and the full funding limits of section 404 of the Code. Unless it has offsetting deductions or credits, an employer will be taxed on excess assets reverting to it upon plan termination. Of course, if the employer does have offsetting deductions or credits, the value of the deduction under section 404 is diminished. If the employer does not have offsetting deductions or credits, the taxation of the reversion generally will offset any benefit from increased deductions.

Answer 16:

Section 1.401-1(b)(2) of the regulations requires that, as of the time of establishment, an employer intend its plan to be a permanent program. The termination of a plan within a few years after establishment for a reason other than a bona fide business necessity is evidence that the plan was not intended to be a permanent program. Because the permanency requirement is dependent upon all of the surrounding facts and circumstances, the regulations do not set forth a minimum period of plan existence.

Section 6 of the Guidelines is aimed at implementing the permanency requirement. That a plan was involved in a reestablishment or spinoff transaction is relevant in determining whether, at the time of a subsequent termination, the employer intended it to be a permanent program. The Guidelines state that a second reestablishment or spinoff transaction within 15 years of the first transaction will raise a permanency question. To provide guidance to the public, 15 years was established as a general guideline. However, the specific facts and circumstances of each case will determine whether the permanency requirement has been violated.

Answer 17:

Section 412(d) of the Code provides that the Service may grant minimum funding waivers in cases of substantial business hardship. It also specifies certain factors that are to be considered in determining whether an employer has incurred a substantial business hardship, such as whether the employer is operating at an economic loss and whether it is reasonable to expect that the employer will continue the plan only if the waiver is granted.

In judging whether to grant a hardship waiver, the Service considers all facts and circumstances. To the extent it is relevant in any particular case, the status of a plan as a "successor" plan will be considered. This factor may be important in determining not merely whether a waiver should be granted, but also what restrictions should applied as a condition of the waiver. There is not an intention at this time to issue general rules for what is essentially a case-by-case inquiry.

* * *

I hope that this discussion aids you in evaluating the Guidelines. Be assured that we are dedicated to preserving the integrity of the private pension system, and to that end we will work with you in further examining the issues associated with asset reversions and the security of participants' benefits.

Sincerely,

Ronald A. Pearlman
Assistant Secretary
(Tax Policy)

The Honorable
Edward R. Roybal
U.S. House of Representatives
Washington, D.C. 20515

Enclosure

B. AGENCY BACKGROUND MEMORANDA

Assistant Commissioner
(Employee Plans and
Exempt Organizations)

Washington, DC 20224

DEC 7 1983

B-1

Mr. Edwin M. Jones
Executive Director
Pension Benefit Guaranty Corporation
2020 K Street, N.W.
Washington, DC 20006

Dear Ed:

Increasing attention has been focused in recent months on the issue of defined benefit plans terminating with surplus assets, where the surplus reverts to the employer. Under the Code, an employer is allowed to receive surplus assets from a terminated plan upon the satisfaction of all liabilities provided the excess is due to actuarial error. However, in some situations there are serious questions regarding the techniques being used to extract assets from plans. Two of the questionable techniques may be called the termination/reestablishment technique and the spinoff/termination technique.

Under the termination/reestablishment technique, an employer terminates an overfunded plan and recovers all excess assets. The employer then establishes a new defined benefit plan (perhaps identical to the terminated plan) for the affected participants.

The spinoff/termination technique may be exemplified by the following example. An employer splits its overfunded plan into two plans, one covering active employees and the other covering retirees. The employer then terminates the plan for retired employees and recovers the excess assets.

The principal affect of both techniques is that the employer is able to obtain plan assets that would not otherwise have been available while continuing a qualified defined benefit plan.

The techniques described present the possibility for serious abuses. The Service has been concerned about these abuses and has been studying the situation and the issues involved. In a recent meeting of the IRS-Treasury Policy Committee attended by the Commissioner, the Assistant and Deputy Assistant Secretaries for Tax Policy of Treasury, the Associate Chief Counsel (Technical) for the IRS and me, a decision was reached on the Internal Revenue Service policy in this area and the courses of action that are to be taken in an attempt to prevent the abusive recovery of excess assets.

The first approach involves application of the substance-over-form doctrine. Under this approach it is recognized that although each step in the process of recovering excess assets is permissible when considered independently, the substance of the transaction is that assets have been removed from an ongoing plan in violation of the Code. Thus, the substance of the transaction will be the primary determinant of the permissibility of the series of steps, not the validity of the formally independent steps. This approach may, in appropriate circumstances, also be applied to situations involving underfunded plans and the spinoff/termination technique in which the accrued benefits of participants are reduced.

The second approach to be used is called the actuarial error theory. This approach would apply only to the spinoff/termination technique. Under this approach, it is maintained that the surplus assets did not arise from actuarial error but from the spinoff of the plan. Thus, the employer would be precluded from obtaining the surplus assets.

Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately.

Sincerely,

S. Allen Winborne

Revenue Service

B-2

date: March 22, 1984

to: Stephen R. Kroll
Acting Assistant to the Commissioner

from: Peter K. Scott
Acting Special Assistant to the Chief Counsel

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subject: Cabinet Counsel Decision on Reversion of Excess Assets

Our preliminary review of the proposed joint statement of policy, and the underlying decisions it represents, has revealed the following areas of concern.

I. Legal/Administrative Difficulties for Service

A. The Policy Statement says current law requires that terminating plans either pay employees their accrued benefits or provide annuity contracts insuring those benefits. In fact, section 401(a)(2), and the regulations under that section, say only that such benefits must be "satisfied." Although the Service has provided in a series of revenue rulings that an employer may receive a reversion of surplus after providing for accrued benefits either through lump sum payments or annuities, it has apparently never stated that these were the only methods of "satisfying" such liabilities. The legal authority to do so would have to derive from section 401(a)(2). This issue apparently never has been raised, possibly because an annuity is ordinarily the cheapest way of providing the level of certainty the Service would undoubtedly require. However, it is worth noting that in a letter to Secretary Chapoton dated February 2, 1984, a large group of respected pension experts suggested a number of different forms of "dedicated assets" which would accomplish the same thing.

B. With respect to spin-off-terminations (in which a plan is divided into two parts, surplus is put into one part, and that part is terminated) the Policy Statement provides conditions to be satisfied if the termination occurs "shortly after" the spin-off without "an independent business reason." These conditions are that the benefits of all employees must be both vested and annuitized as of the date of the transfer (including those employees who continue to be covered in the ongoing plan and all employees must be notified as if it were a full termination). Do either IRS or PBGC have the authority to impose such conditions? If so, who will determine whether the circumstances justifying imposition of the conditions have occurred, and what criteria will they use? Who will decide what those criteria are, and what will happen in the event of conflict between IRS and PBGC?

1. Authority - There is nothing in the Internal Revenue Code which supports imposition of conditions on the continuing plan where a spun-off plan is terminated. Nor is there any explicit support in Title IV of ERISA (which governs PBGC). The argument in support of imposing such conditions would have to be that the agencies could apply substance over form principles to deny that any complete termination had occurred. The conditions at issue are merely safe-harbor circumstances justifying a conclusion that the interests which would be protected by application of substance over form principles have been adequately secured. Thus, the authority to impose conditions derives from the authority to ignore the transaction entirely. While this position is superficially appealing, it is entirely possible a court could conclude that the conditions sought to be imposed have no relationship to the underlying issue, and that the Service may ignore a transaction if the facts justify that treatment, but may not impose requirements as conditions of recognizing the form of such a transaction which it otherwise has no authority to impose under the Code. A similar analysis would apply to PBGC.

2. Criteria for imposing conditions - The Policy Statement would impose conditions only if one of the plans is terminated "shortly thereafter without an independent business reason." The phrase "shortly thereafter" is subject to considerable interpretation, as is the determination of whether there was an "independent business reason" for the termination (assuming that there are sympathetic situations in which there is a business reason for putting the excess assets in the plan which is to be terminated). The background documents indicate no consideration of what "shortly thereafter" means. They also indicate that PBGC would have a considerably more expansive reading of the independent business reason requirement than would IRS (or at least Chief Counsel). Further, expressly stating these criteria in the Policy Statement is disadvantageous to IRS in that it locks the agency into using those criteria in making its determination and also perpetuates the administrative difficulties that would be inherent in making that determination in every case. Our preliminary preference is to remove these phrases from the statement, and to provide merely that in a spin-off termination an employer generally may not recover surplus unless the stated conditions are satisfied. The Assistant Commisioner, EP/EO, agrees.

3. Who will make determination and impose conditions? When a plan terminates PBGC must determine that the assets are sufficient to satisfy the liabilities, and issue a notice of sufficiency if they are. However, PBGC is concerned only with guaranteed benefits (i.e., those insured by PBGC) and not with accrued benefits. Indeed, PBGC only insures benefits vested other than as a result of the termination, and only up to a maximum of less than $19,000 for any participant. Consequently, there is doubt as to whether PBGC has the authority to require conditions unrelated to benefits it insures, particularly where the conditions are imposed on a plan not actually terminating. Even assuming PBGC has the authority to require vesting and annuitization of accrued benefits of all participants (including continuing participants), it is still debatable whether PBGC would require anything other than security for guaranteed benefits. Indeed, PBGC has no particular institutional reason to require anything other than protection of guaranteed benefits, since those are the only benefits PBGC can be required to insure. For the same reasons, PBGC may be less inclined than IRS to invoke the conditions at all. In addition, there are some limited classes of plans that are not subject to PBGC jurisdiction. For all these reasons, IRS would need to monitor and make determinations in all spin-off-termination cases, and probably wind up as the only agency effectively enforcing this rule. This raises some interesting questions. What if PBGC issues a notice of sufficiency in a case in which the Service believes the spin-off-termination conditions should be imposed?

C. There are a number of issues concerning includability of the surplus in the employer's income that have never been addressed by the Service. It has always been assumed, based on dicta in Committee Reports relating to Employee Plans, that amounts reverting to employers were fully includable as ordinary income. In the past this has not been an issue so far as we can determine, probably because relatively few overfunded plans were terminated and because the employers involved were nervous enough about the treatment of the plan termination to forego raising any income inclusion issues. However, if a policy permitting relatively easy extraction of surplus is adopted, we surmise that it will not be long before the companies involved (particularly where very large reversions occur) question full income inclusion.

It is simply not clear what principles of income taxation should apply. The excess assets consist of both amounts contributed by the employer, and untaxed appreciation. Presumably, any part of the return of assets attributable to contributions would be subject to the tax benefit rule. Here the questions include whether the entire reversion should be considered attributable to contributions; whether the reversion should be allocated to yearly deductions on a FIFO, LIFO, or some other basis; and whether contribution carry-overs have any relevance. It is assumed that the untaxed appreciation would not be subject to the tax benefit rule so that if the reversion exceeds all deductions taken, or if the reversion is considered to consist in part of previous deductions and in part of untaxed appreciation, there is a question as to what rule, if any, justifies taxation of this amount. While these problems are clearly not insurmountable, we believe that there may be some exposure here and that the problem will be exacerbated by permitting termination-reestablishments and spin-off-terminations.

D. The Policy Statement says that PBGC will issue rules exempting a "successor plan" from the five year phase-in of benefit rules applying to newly established plans. We are not clear as to PBGC's authority to define a reestablished plan as a successor plan. Moreover, assuming PBGC's authority to do so, what will it define as a successor plan? The answer is important because if PBGC applies the phase-in rules to these plans, the benefits of plan participants in the period shortly after the excess assets have been stripped from the plan will not be guaranteed except to the extent the minimum funding provisions do so. The interests of PBGC and IRS are not identical here, since IRS would prefer a broad definition of "successor plan" in order to provide the greatest possible guarantee, while PBGC would tend to prefer a narrower definition subjecting it to less potential liability. There is considerable room for disagreement between the two agencies as to what the criteria are for concluding that a new plan established by an employer who terminated his previous plan is not a new plan but rather a "successor" plan.

II. General Policy Considerations

Aside from specific problems IRS and/or PBGC may experience in implementing the new policy, it is worth repeating that there are a number of abuses sanctioned by that policy. To the extent IRS accepts the policy, it also has to accept the abuses. These include:

> A. The ability to use an Employee Plan as a vehicle to accumulate tax free amounts of income which can be extracted at any time;

B. The ability to avoid the full funding limits by taking out assets at a time when the plan is nearing its full funding limitation and then continuing to fund on the basis of benefits calculated by reference to all past service;

C. The ability to use prior contributions to fund current minimum funding requirements.

These things are possible largely because the Policy Statement permits termination of a defined benefit plan to be followed instaneously by reestablishment of the identical plan covering the identical participants for the identical services. All manner of planning opportunities are presented, particularly when one considers that even under ERISA considerable voluntary overfunding of pension plans is possible. An employer may first produce a plan with a considerable nest egg of excess assets. Then, it may engage in a number of different sorts of arguably abusive transactions. It may use the assets to absorb expiring NOLs. It may periodically spin-off participants into a new plan, terminate that plan, and use the excess assets to meet its minimum funding requirements of the continuing plan. It may affect its full funding limits rather easily by terminating and reestablishing, with new funding limitations. If a policy is adopted permitting termination-establishments and spin-off-terminations, legislation may be necessary to control instances of these abuses.

cc: Mr. Golberg
Mr. Connett
Mr. Winborne
Mr. Marget
Mr. Cohen
Mr. Posner
Mr. Wickersham
Mr. Bosco

al Revenue Service
memorandum

B-3

date: April 7, 1984

to: Commissioner

from: Stephen Kroll Steve
Assistant to the Commissioner

subject: Reversion to Employers of Excess Assets

This memorandum, prepared after consultation with the Office of Chief Counsel, discusses certain employee protection and tax policy considerations raised by the draft Joint Statement of policy concerning reversion to employers of excess assets of defined benefit pension plans. The memorandum concludes that transactions permitted by the Joint Statement will in some cases reduce the protection of employees below the level guaranteed by the funding standards of section 412 of the Code. It is possible to design approximate solutions to the systematic underfunding that termination-reestablishment and spinoff transactions may create, although the Service's authority and ability to implement the solutions are somewhat problematic. At the same time, the transactions raise questions of tax policy independent of the regulatory aspects of the qualification rules. Solution of these problems, in the absence of a fundamental change in the policy, will require legislation.

Aspects of present law. The Code subsidizes the creation of qualified defined benefit pension arrangements by permitting employers to claim deductions for contributions to pension trusts at a rate far faster than that which would be permitted under the normal accrual rules of section 461 and permitting the fund thus created to compound at a pretax rate. These subsidies are premised on the notion that rapid fund accumulation benefits employees by promoting plan financial solvency. The funding rules of section 412 are designed to insure that the favorable tax treatment is only obtained for funding that is sufficient to pay for promised benefits.

The keystone of the tax subsidies is plan permanence. To a certain extent, any reversion of assets is contrary to the subsidy, even when a plan is terminated with no replacement, but reversion is permitted in that circumstance (so long as the surplus arose from actuarial error rather than a change in plan design) because all liabilities have been satisfied. Treas. Reg. 1.401-2. Two aspects of the Joint Statement exacerbate the problem. First, plans similar or identical to the plans from which surplus is withdrawn are to be continued, so that the withdrawal is at odds with the funding requirements and tax subsidies that created the assets in the first place. Second, implementation of the policy can be expected to make terminations more common and to transform theoretical problems into actual revenue loss for the Government.

The issue is how to accomodate these difficulties within the scope of the Cabinet Council decision.

Funding and Employee Benefit Security. The funding rules require early accumulation of the assets necessary to meet prospective plan liabilities and work to insulate the accumulation of those assets from the risks of plan experience or of the employer's business. The details of the rules are complex, but their overall purposes are accomplished in three ways. First, conservative assumptions are required to be made about asset values and projection of actual benefits promised must be made on the basis of estimated ultimate salary and years of service. Second, no less than level funding of liabilities so projected is required. Third, favorable or unfavorable experience cannot be taken into account all at once, but must be amortized over fixed periods. A potential decrease in liabilities (which may be reversed in the future, if, for example, assets that have risen in value, more rapidly than expected, drop in value) may not reduce the stream of necessary contributions too quickly, and a potential increase in liabilities must begin to be funded immediately. All of this attempts to place valuation and satisfaction of the plan's liabilities on a "going-concern" basis. The operation of these rules normally will produce a surplus, at various points, if the plan is valued on a termination basis.

At the same time, extraordinary market movements or unexpected business changes can create a significant plan asset surplus whose economic value cannot be realized by an employer other than over a statutory amortization period. An extraordinary market gain of, say, $15 million, even if preserved, will only benefit the employer at a rate of $1 million per year for 15 years. This is the circumstance that more than any other led to the desire to permit legitimate reversion transactions.

Unlike the situation dealt with in the traditional regulations, however, the desire is to permit reversions while the plan continues. The question is whether, and how, to distinguish between that portion of the plan surplus that represents extraordinary gains to the plan due to market movements and other operational factors and that portion represented solely by the normal accelerated funding that the Code requires to protect employees. The need to draw such a distinction appears significant.

There are two ways to approach the problem. The first is to recognize that, once the status of an ongoing plan is recognized, the Congressional policy of the funding rules dictates the terms on which plan benefit security must be evaluated. (Of course, administration of these rules is the responsibility of the Service, not the PBGC.) The second is to attempt to approximate the security objectives of the funding rules by other means; that is the tack taken by the Joint Statement. However, even on its own terms, it appears that annuitization and vesting for accrued benefits may not always be sufficient to protect employees.

Attached is a memorandum prepared by the Employee Plans Organization that demonstrates that in some situations post reestablishment or spinoff funding may not be sufficient to accumulate assets necessary to pay for benefits accrued after the reversion occurs. The problem is most easily demonstrable in situations in which the work force is composed of older employees or in which benefits not insured by the PBGC--most importantly those paid to encourage early retirement--are promised by the plan. It is possible that the same problems can arise, for example, if salary scales increase more rapidly than anticipated. Moreover, the calculations on whose basis these examples were prepared assume that the successor or ongoing plan is at least able to fulfill its actuarial assumptions. If assets perform less well than anticipated, the only protection to the plan is continued employer solvency and willingness to put additional funds into the plan over a shorter period than would otherwise have been necessary.

At the same time, of course, the protections in the present Policy Statement narrow the range of cases in which a serious problem, in the absence of a down market, can be predicted. A portion of the risk involved in reducing plan reserves is inherent in the policy of permitting any reversion at all.

Solutions. Assuming that at least a potential funding deficiency exists, whether on the basis of the standards of the funding rules or predictable situations following asset reversions, there are three potential solutions. The first is to attempt to deal simply with the funding problems demonstrated for particular re-established plans. Those solutions are discussed in the attached memorandum from the Employee Plans Organization.* It appears that those solutions would solve at least the most serious of the problems involved. Counsel believes that the Service's authority to regulate funding methods would extend to the requirement of special funding bases in the event of termination transactions.

At the same time, a solution based on particular problems will deal only with some of the problems and risks involved in permitting plans to switch from a going concern to a termination basis and back again within the economic life of a particular plan. The fact remains that surplus accumulated pursuant to the funding rules will be withdrawn.

A more general and conceptually consistent solution would be to calculate the amount of the surplus allocable to extraordinary experience gain and the amount produced by normal operations of the funding rules (what one might call "funding gain"), at the outset and require the latter to remain in the plan. This was the purpose of the proposals that a cushion be withheld from the permitted reversion.

There are a number of difficulties with this solution. First, it is difficult to identify and differentiate experience gain and funding gain. In an ongoing plan, experience gain consists not only of market appreciation of assets, but gains related to any other aspects of operation of the plan such as increased mortality, less vesting than supposed, more early retirments, cost savings, and the like. Each time experience gain is recalculated (which must occur no less frequently than every three years) underlying assumptions are also changed, so that after some years of operation, to compare assets accumulated to those which would have been accumulated under a static set of assumptions is somewhat akin to unscrambling an egg. Moreover, funding itself during preceding years has been predicated to some extent on the periodic recalculation (and amortization) of experience gain and loss. Thus, on a plan-by-plan basis it would be very difficult, if not impossible, to identify precisely that part of a surplus attributable to the funding standards and that part attributable to extraordinary experience of the plan.

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*The objections raised by the Employee Plans Organization to implementation of the solutions are discussed below.

Given the difficulties with specific calculation solutions, the possibility suggests itself of a requirement that an asset cushion calculated according to some arbitrary formula remain in a plan engaging in a reestablishment or spin-off transaction. The requirement would have to be based on the Service's general authority to disregard termination-reestablishment or spinoff-termination transactions.

Objections. Three sets of objections have been offered to the sorts of solutions suggested above. The first is that the solutions will be difficult to administer and will require potentially costly calculations even in situations in which no remedial action is ultimately necessary. Moreover, imposition of conditions will increase the risk that the policy will be subject to legal and political challenge on the ground that, in the former case, the Service has exceeded its authority, and in the latter, that it has not exercised its authority sufficiently effectively. These considerations in part influence the recommendation of the Employee Plans Organization in its memorandum that the funding solutions it devised not be implemented.

The second set of objections is that any of these solutions will increase costs and decrease the amount of available reversions and thus is inconsistent with the basic decision taken at the Cabinet Council. However, in a real sense the solutions are part of an attempt to implement a portion of the Cabinet Council's decision, which sought to encourage the maintenance of successor plans on the basis of the past service of affected employees. These solutions are necessary to make that promise workable in light of applicable statutory standards.

The third set of objections, a corollary of the second, is that the funding and asset cushion requirements cannot be proved to be necessary prospectively and their imposition will simply provide additional incentives to the termination of defined benefit pension arrangements altogether. That is ultimately the heart of the matter and is simply a matter of subjective policy analysis. However, the Service has a direct institutional responsibility for enforcing the standards Congress has chosen to enact for employers who do chose to maintain defined benefit arrangements and an attempt to apply those standards to the reversion situation, in however imperfect a way, may well stand the agency in a better stead than simply attempting to distinguish away termination transactions when taxpayers in other situations attempt to argue for termination based funding or other exceptions to the funding rules. Moreover, the funding rules are designed to protect against the unpredictable (as are all insurance reserve arrangements) and the fact that reserves cannot be proved always to be necessary is not an argument for ignoring the requirements of section 412.

Summary. Both the technical and institutional risks of doing nothing (for employees and for the Service) described above seem real, although extremely difficult to quantify. The most conceptually acceptable solution is to attempt to distinguish between funding and extraordinary experience gain and only permit the latter to be the subject of reversion in a situation in which an on-going plan is contemplated. I believe that the Employee Plans Organization would argue that computation of distinct portions of surplus would be difficult, but I believe that acceptable conventions could be worked out. I think that this approach should be discussed with Treasury, because it is the one most likely to maintain the vitality of the funding rules and it would bring resolution of the asset reversion issue as far as possible within the scope of existing rules. However, opposition from the Department of Labor and the PBGC to this approach can be expected.

A second approach would be to make it clear that an employer could ordinarily only engage in one plan termination reestablishment or spinoff transaction for a group of related plans every 15 years (the normal statutory period for amortization of experience gains) and to give the Employee Plans Organization the explicit authority to implement in appropriate cases the two options described in its memorandum, as part of the condition for permitting the plan termination transaction and reversion to occur.

Tax Policy. More basic questions of tax policy remain. An employer that recaptures assets for whose contribution it has received a deduction and which have accumulated tax free is reaping a significant tax benefit even assuming that the reversion is included in income. The benefit derived from offsetting an early deduction with income in a later year is not unlike that derived from an investment in a typical abusive tax shelter or the sorts of situations to which the Administration's "time value of money" proposals are directed. The tax free build up of assets, of course, makes it impossible ever fully to balance the equation, because there will be a crossover point at which the taxpayer will realize a net gain even assuming ordinary income inclusion of the reversion.

The problem has two parts--assuring inclusion of the reversion in income and neutralizing the time value of money gaming involved. As to the first, the simplest solution would be a statutory provision including the reversion in income without any offset for loss carryovers. The solution to the second problem is more difficult. A statutory formula could be worked out to erase the cross-over point by attempting to assess a tax based on the tax revenue foregone because of the prior tax exemption fof gains over a certain level. However the simplest solution would likely be a simple excise tax on the total amount of the reversion.

Internal Revenue Service
memorandum

B-4

date: May 21, 1984

to: John E. Chapoton
Assistant Secretary of the Treasury (Tax Policy)

from: Stephen Kroll Steve
Assistant to the Commissioner

subject: Continuing Policy Concerns relating to Proposed Policy on Excess Assets

Attached is a completely rewritten draft of a memorandum setting forth the continuing policy concerns of which we believe the Cabinet Council should be made aware before deciding whether to go forward with resolution of the excess ssets issue on the basis of the joint statement of policy. The Commissioner reviewed this draft prior to leaving the country Saturday and has approved its use in the manner you described on Friday.

Harry has a copy of the draft, but I have not yet been able to discuss it with him. It is a vast improvement, I think, over the draft he received on Friday.

I would be happy to come over to your office to go over the memorandum with you if you would like. I should need no more than 20 minutes notice to do so.

Attachment

cc: (w/attachment)
Harry Conaway

Never Finalized

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MAY 21 1984

To: Cabinet Council on Economic Affairs

Continuing Policy Concerns raised by Proposed Policy On Reversion of Assets from Pension Plans

The Cabinet Council on Economic Affairs has been asked to reconsider proposals for a joint policy statement, to be made by the Department of the Treasury, the Department of Labor, and the Pension Benefit Guaranty Corporation ("PBGC"), setting conditions under which employers would be permitted to recover surplus assets from defined benefit pension plans. The Department of the Treasury and the Internal Revenue Service have participated in the drafting of that statement. This memorandum is submitted to express broad policy concerns that the Service and Department feel should be considered by the Council before deciding whether to deal with the problem generated by the existence of pension plan reserve assets in the manner proposed by the policy statement.

The Problem. The problem which the Council has been asked to address is simply stated. Defined benefit pension arrangements are funded on an advance basis, under rules contained in the Internal Revenue Code and labor laws, with significant, and costly, tax subsidies. The plans are generally required to be funded on an on-going basis, so that contributions are based on projected final benefits (depending on such factors as salary levels at retirement) rather than benefits actually earned to date.

Extraordinary market movements or unexpected business changes can cause the value of a plan's assets to exceed the value of benefits actually earned to date. Such an excess, or reserve surplus, is treated as an extraordinary item under the funding rules. It does not reduce necessary contributions immediately (because the surplus may disappear if assets that have risen in value more rapidly than expected, thereafter drop in value), but rather over a period of 15 years.

Employers have traditionally been permitted to recover assets not needed to satisfy liabilities when a plan's life ends, so long as this excess resulted from over-calculation of what a plan's liabilities would be. Current market and business conditions have led to an attempt to push the traditional rule further by seeking ways to validate ending a plan, recovering an excess of assets over termination liabilities, and replacing the plan with a second plan covering the same employees. (These are referred to as "termination-reestablishment" transactions.) A variation involves splitting a plan into two parts, allocating the surplus reserve to one of the parts, and terminating that part (which usually covers only retired employees whose final benefits are fixed), and recovering the suprlus..

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In either case, the net effect is to draw assets through a series of formal steps from what is in substance an on-going pension arrangement. By engaging in these steps, assets that constitute a statutorily required (albeit overlarge) reserve surplus on an on-going basis are made to appear as "excess" assets by freezing the financial picture at a single point.

The problem is how to reconcile the statutory requirements of conservative funding of pension obligations - which demands financial calculations on an "on-going" basis - with the problems of employers whose plans contain a significant surplus whose economic value can only be realized over a 15 year period.

Previous Action. Discussions of the "surplus" asset problem at the staff level have been on-going since last July. In late December of last year, a Treasury-Internal Revenue Service Policy Committee meeting decided to challenge the validity of transactions designed to generate an asset "excess." Thereafter, in response to concerns expressed by the PBGC, the Treasury Department began to develop options, together with the PBGC, under which asset reversion transactions could proceed if certain conditions were satisfied.

A version of the proposals was presented to a meeting of the Cabinet Council in March. However, the Internal Revenue Service had not been consulted sufficiently at appropriate levels prior to the March meeting. More importantly, the Service was concerned that the new policy direction as then formulated might not adequately protect the security of employees' benefits and the Service's responsibility to administer the funding rules and certain aspects of the income tax laws.

On April 4, the Administration delivered testimony before the Senate Labor and Human Resources Subcommittee which emphasized that examination of the asset reversion problem was on-going. Immediately after the testimony, representatives of the agencies began to re-examine the terms of the joint statement.

Joint Statement. The proposed joint statement offers a solution to the problem by committing the PBGC and Service to issue administrative clearance for termination of defined benefit plans, and recovery of surplus assets in connection therewith, if certain conditions are met. The conditions include vesting of all participants and the purchase of annuity contracts to cover benefits accrued to date (so that no reserve covering those benefits is necessary). At the same time, the joint statement would explicitly permit the a new plan to be established to cover the same group of employees at the same benefit levels, on the understanding that the PBGC will treat such a plan as a "successor" plan exempt from the five year waiting period for full insurance protection.

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The joint statement would thus permit a plan to be taken 'into' and then 'out of' termination status, to produce a recapturable reversion, so long as the employer meets conditions that are designed to approximate the financial security objectives of the funding rules by other means. The protections, if implemented, would narrow the range of cases in which a serious problem, in the absence of a down market, can be predicted.

At the same time, however, dealing with the problem in this way raises a set of serious policy concerns which the Service and Treasury Department feel should be thoroughly canvassed by the Cabinet Council before a final decision is made. These problems are both administrative and political, and involve revenue considerations as well as regulatory issues.

Administrative Concerns. The policy embodied in the joint statement expands significantly prior exceptions to the administrative rules by permitting extraction of amounts which appear to be 'surplus' at a particular time, although a plan similar or identical to the one from which the surplus is withdrawn is to continue. The surplus itself arose through compliance with Congressionally mandated funding rules; the need for a surplus reserve, as in all insurance arrangements, is real, if difficult to quantify. The funding rules are designed to protect against the unpredictable (as are all insurance reserve arrangements); in this case the unpredictable is the risk of employer inability to continue to fund an ongoing arrangement, or a sudden drop in asset value. It is never possible to prove beforehand whether the reserves will prove necessary. The argument that employers can end pension arrangements altogether - and legally recover reserves under traditional rules - is a thin reed on which to create an exception to a governing statutes that apply when they do not end the arrangements but continue them.

The workability of the administrative compromises in the joint statement assume continued employer solvency, or PBGC ability fully to insure benefits; the risk against which accumulation of reserves protects is thus shifted to the PBGC or, ultimately, the employees (since the PBGC does no insure all benefits). This is not to ignore the need to deal with the problem of overlarge surpluses whose value is denied the employer, but to question whether an administrative solution will stand the test of even short-term time. The policy proposed is built on a series of accomodations between agencies operating under different statutory mandates. It can be robbed of its effectiveness by a challenge directed to a single part of the package. A challenge can be expected.

Revenue Considerations. Some basic questions of tax policy are also involved. An employer that recaptures assets, for whose contribution it has received a deduction under exceptions to normal tax principles, and which have accumulated tax-free, is reaping a

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significant tax benefit even assuming the reversion is included in income. The benefit dervied from offsetting an early deduction with income in a later year is not unlike that derived from an investment in an abusive tax shelter or the sorts of situations to which the Administration's "time value of money" proposals are directed. Moreover, in many situations employers with significant tax credits, other deductions, or loss carryovers, may not be required to include the reversion in income at all.

It has been argued that there is insufficient data to prove employer's can intentionally use pension plans as "tax-free savings accounts" if asset reversions are permitted. That is beside the point. There is no dispute that a significant wind-fall would accrue to an employer who recaptured assets. There is no clear administrative solution to the problem.

Political Considerations. There seems little question that the policy contained in the joint statement will be subject to strong public criticism as an example of preferring the needs of employers to that of working people covered by pension plans. Some of the criticism can be expected to be strident or unhelpful. While approaches such as Senator Metzenbaum's may not represent a serious threat in themselves, because they unrealistically pose the issue as an all or nothing choice, others in Congress can be expected to react adversely to what appears to be a somewhat result-oriented creation of exceptions to long-standing rules for plan solvency, specifically endorsed by Congress a decade ago. It is not difficult to picture the policy as a special-interest exception to normal rules, stitched together to permit these transactions at the expense of the needs of employees for economic security. It is equally difficult to prove that reserves are unnecessary as it is to prove that they are necessary.

Moroever, to the extent that authority to implement the policy in the joint statement depends on a potentially broader present legal authority to deal with the reversion issue, the defense that current statutes do not permit a more aggressive stance will be unavailable in the event of a political attack. To court such controversy, especially while major tax and budget legislation is pending, appears to offer serious risks to more important programs.

Legislative option. An alternative approach would be preparation of legislation specifically revising the funding rules to define the terms on which reserves could be returned to the employer as unnecessary to protect employees. Such legislation would permit the Administration to fashion a more flexible and effective tool to accomplish the policies endorsed by the Cabinet Council; it would permit the revenue loss issue to be addressed and, more importantly would foster a more permanent solution to the problem. The policy outlined in the joint statement could be the building block for such a legislative proposal.

B-5

date: MAY 28 1984

to: Commissioner

from: Stephen Kroll,
Acting Assistant to the Commissioner

subject: Reversion of Excess Assets Upon Termination of Pension Plans

This memorandum discusses the issues raised for the Internal Revenue Service by the attached Joint Statement of Policy (the "Joint Statement") concerning reversion to employers of excess assets upon the termination of defined benefit pension plans. (The Joint Statement derives from a decision made at a meeting of the Cabinet Council on Economic Affairs held last week.) The memorandum is based on discussions of the issues in preliminary memoranda prepared by Mr. Winborne and Mr. Scott (copies also attached) and at a meeting held earlier today and attended by Mr. Winborne, Mr. Cohen, Mr. Scott, and members of their respective staffs.

Implementation of the policy described in the Joint Statement is feasible, although administrative risk is involved in such implementation. The risk can be lessened somewhat by changes in the language of the Joint Statement and quick discussions about coordinated administration of the policy there described.

Outline of the Joint Statement. The Joint Statement commits the Pension Benefit Guaranty Corporation (the "PBGC") and the Service to issuance of administrative clearance for termination of defined benefit plans and recovery of surplus assets in connection therewith, in accordance with the following rules.

1. In all situations, all accrued benefits must vest. Annuity contracts must be purchased for all vested benefits unless employees are offered lump sum cash payments that fairly reflect the value of those benefits under guidelines developed by the PBGC.

2. A "successor" defined benefit plan established to cover the same group of employees will be exempt from the five-year phase-in of PBGC benefit guarantees that applies to newly-established plans. The terminated and successor plans may together provide benefits equivalent to those that would have been paid if the prior plan had continued without interruption.

3. In the case of a spin-off/termination the accrued benefits of all employees (including most importantly those in the ongoing plan) must be fully vested as of the date of the spin-off and benefits accrued to the date of transfer must be provided for by the purchase of annuity contracts.

4. All employees must be notified of a spin-off/termination prior to its occurrence, in the same manner as if the ongoing plan were to be terminated.

The most significant issues raised by the Joint Statement are discussed in the remainder of this memorandum.

Service Authority. The legal authority of the Service to require vesting of otherwise nonvested participants in the ongoing plan, on account of a spin-off/termination, is tenuous. The strongest argument that can be made is that such vesting is a condition of a safe-harbor from application of the "substance-over-form" doctrine to disregard the spin-off, and hence bar the reversion, altogether. However, it is not clear that the ability to disregard a transaction carries with it the authority to impose conditions for not arguing that the transaction should be disregarded. Moreover, to the extent that authority to implement the Joint Statement depends on potentially broader present legal authority to deal with the reversion issue, the defense that the current statute does not permit a more aggressive stance will be unavailable in the event of a political attack.

The Employees Plans Organization feels that, the likelihood of anyone challenging the vesting condition is small because employers will gain more from access to asset surpluses than they will lose by vesting some additional employees before completion of the normal service periods. (The chance that a successful challenge would lead to legislation will also cause employers not to challenge the vesting condition, in Employee Plans' view.) Counsel believes that the Service would have a defensible position in response to a legal challenge.

In short, the Service may have to fight the same legal battles under the Joint Statement that it would have had to fight under any more aggressive approach to the problem, as well as facing a challenge to its authority impose conditions, which it otherwise has no authority to impose, for respecting the form of a transaction. This risk should be clearly understood, but there is no way short of altering the policy, of eliminating it. In my view, the question here would be close in some other context but does not at this stage justify a direct challenge to the policy.

Criteria for imposing conditions. The Joint Statement suggests that conditions would be imposed upon a spin-off/termination only if the termination occurs "shortly [there]after" the spin-off "without an independent business reason." Counsel believes that inclusion of the quoted terms in the Joint Statement can lock the Service into ambiguous (and perhaps inappropriate) criteria for application of the substance over form doctrine as well as creating administrative burdens. It recommends deleting the language. Employee Plans does not object, but does not believe a deletion is necessary. I agree with Counsel.

Administrative Coordination. The success of the Joint Statement depends on the development of criteria agreeable to both the PBGC and the Service as to several matters, including the definition of fair cash values for lump sum payments, the definition of successor plan in a termination re-establishment for which the PBGC would waive its five-year phase-out rule), the extent of imposition of vesting and annuitization conditions, and the definition, and application of the definition, of spin-off/termination. However, the interests of the two agencies are not uniform, and may even be opposed in some situations. There is no mechanism for assuring a uniformly satisfactory interpretation of these policies. My guess is that criticism in the absence of uniform treatment will be directed at the Service, whose statutory brief is broader than that of the PBGC.

It would be advisable, in my view, to create a formal mechanism to sort out problems of joint administration.

Severability. The Joint Statement does not speak to what happens if one component of the policy proves invalid or unworkable. (Most important in this regard is the risk that the PBGC simply does not have the authority to waive the statutory five-year phase-in rule.) An agreement on that point should be reached now. Whether it is publicized is another matter.

Tax Benefit Rule. A statement should be added to the Joint Statement that the income tax consequences of reversions and, in abusive cases, of funding of ongoing or successor plans are unaffected by the Joint Statement. A study project should be initiated in the Interpretative Division without delay.

Pending cases. The present draft of the Joint Statement commits the Service to "proceeding without delay to process all pending termination cases in accordance with the above policies." Mr. Winborne, Mr. Scott, and I all felt that the words "without delay" were inappropriate, because of the need for administrative coordination, and perhaps experimentation, in light of the volume of termination issues that may arise once the Joint Statement is released. Deletion of the words "in accordance with the above policies" is also recommended, because the language may be cited against a necessary interpretation and in any event adds nothing to the document.

This memorandum can be supplemented or expanded in any way that you would find helpful. I will ask Mr. Winborne, Mr. Scott, Mr. Cohen, Mr. Marget, and Mr. Posner to be available on a stand-by basis for a meeting on Monday, so that you can raise questions directly with them if you would like.

Attachment

C. PLAN TERMINATION LISTS

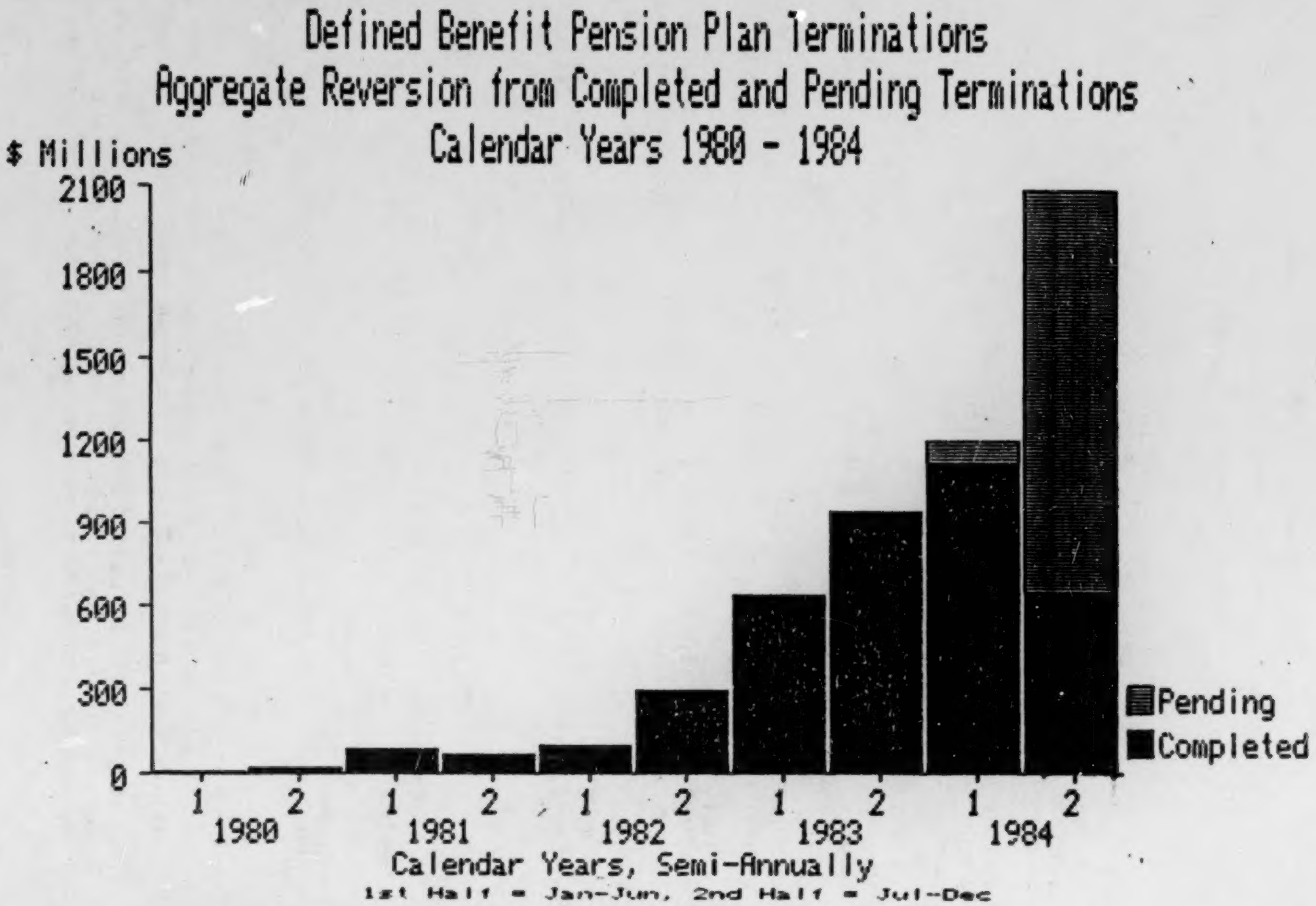
Asset Reversion Data:

Aggregate Reverions from Completed and Pending
Defined Benefit Pension Plan Terminations
Calendar Years 1980-1984, partial 1985

(updated April 1, 1985)

The attached data represents aggregate reversions from defined benefit pension plans which:

A. were terminated between Jan. 1, 1980 and Dec. 31, 1984;
B. are currently pending final approval of a proposed termination by the Pension Benefit Guaranty Corporation.



Defined Benefit Pension Plan Terminations
Aggregate Reversion from Completed and Pending Terminations
Calendar Years 1980 - 1984

Defined Benefit Pension Plan Terminations: Aggregate Reversion from Completed and Pending Terminations, Calendar Years 1980-84, partial 1985

	Participants	Assets	Benefits	Reversion
CY 1980				
complete:	22,065	56,359,512	39,234,963	17,124,549
pending:	0	0	0	0
CY 1981				
complete:	29,905	334,084,199	179,079,193	155,005,006
pending:	433	3,900,000	2,000,000	1,900,000
CY 1982				
complete:	123,647	1,124,557,591	725,773,479	398,784,112
pending:	511	5,900,000	4,700,000	1,200,000
CY 1983				
complete:	161,547	3,332,378,472	1,738,512,991	1,593,865,481
pending:	2,519	35,200,000	23,000,000	12,200,000
CY 1984				
complete:	166,613	3,279,618,620	1,518,420,038	1,761,198,582
pending:	190,895	4,076,100,000	2,533,200,000	1,542,900,000
CY 1985				
complete[1]:	0	0	0	0
pending[2]:	87,935	1,808,900,000	1,054,050,000	754,850,000

	Participants	Assets	Benefits	Reversion
CYs 1980-85				
Complete[1]	503,777	8,126,998,394	4,201,020,664	3,925,977,730
Pending[2]	282,293	5,930,000,000	3,616,950,000	2,313,050,000
Aggregate Reversion:	786,070	14,056,998,394	7,817,970,664	6,239,027,730

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[1] As of April 1, 1985, none of the pending "overfunded" terminations for CY 1985 had yet been issued a notice of sufficiency by the Pension Benefit Guaranty Corporation.

[2] As of April 1, 1985, a total of 66 notices of intent to terminate a pension plan with a proposed date of termination during 1985 had already been submitted to PBGC for approval. Significantly more were expected to be filed during the course of the year.

Reasons for Plan Termination:
Completed and Pending Plan Terminations
CYs 1980-1984, partial 1985[2]

Calendar Year	1980	1981	1982	1983	1984	1985[2]
sale, takeover or merger.	3	5	15	43	41	7
company dissolution, division or plant closing, adverse business conditions or bankruptcy.	1	9	22	26	61	11
cost, ERISA impact, or employer/employee dissatisfaction.	2	9	15	13	6	0
adoption of a superceding plan.	2	7	22	55	130	36
not specified/n.a.	0	4	7	15	55	12

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[3] As of April 1, 1985, no notices of intent to terminate an "overfunded" pension plan with a proposed date of termination between July 1 and Sept. 30, 1985 had yet been filed with the Pension Benefit Guaranty Corporation. However, a total of 65 such notices of intent to terminate with proposed dates of termination during 1985 had already been submitted to PBGC for approval by that date, and more were expected to be filed during the course of the year.

D. OTHER INFORMATION

May 23, 1984

D-1

IMPLEMENTATION GUIDELINES

The following has been adopted by the Department of the Treasury, the Department of Labor and the Pension Benefit Guaranty Corporation to provide guidelines for processing defined benefit pension plan terminations involving asset reversions to the plan sponsor.

1. In accordance with current law, when an employer terminates a defined benefit pension plan, it may not recover any surplus assets until it has fully vested all participants' benefits and has purchased and distributed annuity contracts, to protect participants against the risk that their accrued benefits may be jeopardized by future market fluctuations or other factors.

2. At present, upon plan termination, employers can make lump sum payments to certain participants. In some cases, these lump sums have been calculated on the basis of interest rates that are higher than those available to individuals, thereby reducing the value of those benefits. This problem must be addressed. If employees are offered lump sum payments in lieu of future pensions, the amount of the lump sum must fairly reflect the value of the pension to the individual. The Pension Benefit Guaranty Corporation is developing guidelines for determining appropriate lump sum values.

3. An employer that terminates a sufficient defined benefit pension plan may establish a new defined benefit plan covering the same group of employees. The new plan may grant past service credit for the period during which an employee was covered by the terminated plan (subject to the limitations of Section 415 of the Internal Revenue Code). The prior plan and the new plan, in combination, may provide benefits for each participant equivalent to those to which the participant would have been entitled if the prior plan had continued without interruption. The PBGC will clarify the fact that a successor plan is exempt from the five year phase-in of benefit guarantees that applies to newly established plans. The above is one example of what will be deemed a successor plan by the PBGC.

4. In the case of a so-called "spin-off/termination", generally no termination will be recognized and any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

* The benefits of all employees (including those covered by the ongoing plan) must be fully vested and nonforfeitable as of the date of termination.

* All benefits accrued as of the date of termination in the ongoing plan must be provided for by the purchase of annuity contracts which represent irrevocable commitments for the benefit of each individual participant.

* All employees who were covered by the original plan must be given advance notice of the transaction in similar time and manner as if the entire original plan were being terminated.

5. In the case of a so-called "spin-off/termination" and a so-called "termination/re-establishment" transaction, generally any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

(a) In the case of an ongoing plan described in number 4 above, the funding method for the ongoing plan must be changed on the date of termination by combining and offsetting amortization bases in accordance with §412(b)(4) of the Code. The amortization period for this base will be the lesser of the combined amortization period and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method.

(b) In the case of a new plan established with credit for past service as described in number 3 above, in order to obtain a reversion of surplus assets from the terminated plan, the future amortization period for the unfunded past service liability for the new plan, under Section 412 of the Code, will be the lesser of 30 years and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method for the new plan.

The agencies' analysis indicates that, in spinoff/terminations where the conditions in numbers 4 and 5a are satisfied, the security of participants' benefits is protected by the purchase and distribution of annuities, the statutory minimum funding rules, including the rules described in number 5(a), and PBGC insurance coverage.

6. Employers are reminded that one of the requirements for plan qualification is that the plan be intended to be permanent. In any case, the funding rules generally require that plan funding be on a going-concern basis rather than on a termination basis. Thus, the tax consequences of multiple "termination/re-establishments" or "spin-off/terminations" are unaffected by these guidelines and will be determined without regard to whether the specific guidelines described above are satisfied with regard to each of the transactions. Generally, an employer may not engage in either a termination/re-establishment or spin-off/termination transaction, involving reversion of assets, any earlier than 15 years following any such transaction.

7. The federal income tax consequences of the receipt of reversions, of deductions for contributions to ongoing or successor plans and of the funding of such plans, after the change in funding method, are unaffected by these guidelines.

8. The PBGC will continue to process and the IRS will now proceed to process all pending termination cases.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D C 20500

D·2

MARTIN FELDSTEIN, CHAIRMAN
WILLIAM A. NISKANEN
WILLIAM POOLE

May 23, 1984

Honorable Orrin G. Hatch
Chairman, Committee on Labor
and Human Resources
428 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

On May 9, 1984, the Senate Labor Committee postponed action on S. 1227 in order, as you stated, to allow time for comment by Treasury, DOL, and PBGC on Senator Metzenbaum's proposed amendment to S. 1227 on the subject of asset reversions from terminated pension plans.

The affected agencies have reviewed the amendment (enclosed) and offer the following comments:

(1) The Administration believes that its joint policy announced April 4th reflects a fair and balanced administrative resolution of the issues raised in this area, and we are not prepared to recommend legislative action at this time.

(2) The new approach proposed by Senator Metzenbaum raises many issues. We recognize that these are important matters and are reviewing the alternatives set forth in the amendment as well as other approaches to assure that participants annuities are protected against loss of purchasing power from inflation. We will report on the results of such review to the next Congress.

(3) The Pension Benefit Guaranty Corporation is in serious financial distress and needs the premium increase contained in S. 1227 urgently. Its 110,000 premium collection forms for this fiscal year are due to be mailed to plan sponsors imminently. If the premium increase is not enacted by June 15th, serious delays in collections and losses of revenue will result. The Administration believes the substance of S. 1227 should be kept separate from the unrelated issue of asset reversions.

(4) The Metzenbaum proposal itself presents considerable administrative problems. Two examples:

(a) It would have the Secretary of Labor project inflation rates over the remaining lives of pension participants and let that projection govern the amounts set aside from plan assets for benefit adjustments. This projection necessarily would be arbitrary and subject to dispute and even small variations could drastically affect the size of any reversion. In fact, PBGC estimates that a rate of 5% would eliminate all reversions presently pending at PBGC.

(b) The restriction of reversions essentially to instances of impending bankruptcy is narrow and unreasonable. There are instances of termination reversions supported by both labor and management in order to maintain wages or expand the business. These legitimate actions would be prohibited.

(5) As the attached exhibit indicates, the net effect of the Metzenbaum amendment is virtually to eliminate reversions. We do not believe that this proposal is a constructive approach to the difficult task of balancing the interests of plan sponsors and employees. If employers can never derive a benefit from overfunding, they may well prefer to underfund. In fact, they may prefer not to offer a defined benefit pension plan. This would undermine the very goals Senator Metzenbaum espouses.

Thus, for the above reasons, we are unable to advise favorable action on the amendment. To the extent that it is diverting attention from the pressing need to increase the PBGC's premium and shore up the insurance system, this proposal is jeopardizing the pension security of 65,000 PBGC beneficiaries and 40 million insureds. We urge prompt and favorable action on S. 1227 in the form proposed by Senator Nickles.

The Office of Management and Budget advises that enactment of S. 1227 would be in accord with the program of the President.

Yours sincerely,

William A. Niskanen

William A. Niskanen
Member, Council of Economic Advisers
The White House

John E. Chapoton

John E. Chapoton
Assistant Secretary for Tax Policy
Department of the Treasury

Robert A. G. Monks

Robert A. G. Monks
Administrator - PWPB
Department of Labor

Charles Tharp

Charles Tharp
Executive Director
Pension Benefit Guaranty Corporation

EXHIBIT II

For your information, the table below shows the increased cost of benefits under the provisions of the amendment, assuming different combinations of weighted average age of participants and anticipated inflation rates:

Weighted Average Age	Anticipated Inflation Rate 4%	6%	8%	10%
50	+108%	+161%	+215%	+269%
55	+91%	+136%	+182%	+227%
60	+76%	+113%	+151%	+189%
65	+61%	+92%	+123%	+154%

Note: Life expectancies are based on the UP-1984 table.

The average plan that terminates with surplus assets in excess of $1 million has roughly a 50 percent surplus and would be unable to provide the full benefit increase required by the amendment under any of the combinations of average age and inflation shown in the table. It is therefore likely that the enactment of the amendment would be viewed by employers as tantamount to the outright prohibition of asset reversions.

APPENDIX II

AARP

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

LABOR-MANAGEMENT RELATIONS SUBCOMMITTEE

and the

HOUSE AGING COMMITTEE

on

OVERFUNDED PENSION PLAN TERMINATIONS

June 12, 1985

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700
Vita R. Ostrander *President* Cyril F. Brickfield *Executive Director*

The American Association of Retired Persons, the nation's largest aging organization with over 19 million members, is gravely concerned with the growing crisis of overfunded pension plan terminations. The current accelerated trend of pension terminations for the purpose of recovering excess assets is a clear signal that the law is inadequate, and an immediate moratorium on large terminations, accompanied by legislative change, is needed.

Although this practice has been available in the past, only recently has a combination of factors caused pension termination to become a more common option. The PBGC lists reversions in excess of $3.5 billion since January of 1980, with approximately $2 billion more presently pending. It is clear from the large number of plans, participants and beneficiaries affected that an immediate cessation of plan terminations with asset reversions over $1 million is essential. Legislative relief is then needed to protect participants and beneficiaries from potential abuses.

Plan termination is no longer seen as an indicator of poor financial status, but as a way to increase an employer's cash on hand. This use of surplus funds purely for the self-interest of the employer fails to account for the future needs and expectations of retirees and older workers. A number of major problems thus accompany current decisions to terminate to recoup excess assets.

When an employer terminates a plan, there is no obligation to reestablish a plan. The lack of a new plan, or the change to a different plan, deprives the worker of the benefits of plan coverage or plan continuity. Thus, even though plan terminations require full vesting of all accrued benefits, it does not account for the future expectations of workers and retirees. Employees who continue with the employer lose the chance to accrue future benefits, and the cessation of defined benefit plan coverage may lead to a significant decrease in retirement pension amounts. Those employees who receive only a lump sum distribution may be even worse off, since most generally spend such amounts and do not use the payments to provide for their retirement security.

In addition, current retirees future benefit expectations are frustrated. Retirees in plans that have been terminated will have their benefit amounts frozen at the current level. Thus, the impact of inflation on the real value of their benefits will erode retirement security with no chance for inflation adjustment. The average 65-year-old retiree has a life expectancy of about 17 years. Assuming inflation rates of 5%, the average fixed pension recipient will see an erosion in pension value of 56% in the 17 years. The reduced pension adequacy becomes more acute over time, as the older person's income and savings are drawn down, and medical expenses increase. Clearly, the impact of inflation on pension value can be devastating, and yet there is currently no inflation protection mandated by pension law, nor are there many plausible alternatives. However, one protection, while voluntary, has served to alleviate some of the hardship of inflation's affect upon pension benefits. A recent study showed that of the surveyed plans with 10,000 or more retirees, all had given at least one ad hoc increase in the 1973-79 period. With plan terminations, cost-of-living adjustments and other improvements are effectively denied, and retirees' pension protection is dramatically weakened.

While an exception to current law allows an employer to recapture excess assets, it is difficult, in light of the adverse affect on plan participants, to justify maintaining this exception consistent with ERISA's exclusive benefit rule. ERISA section 403(c)(1) clearly and simply states that "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries." The termination exception allows the employer to recapture the trust assets after the liabilities have been satisfied. The question thus arises, "Who owns the excess assets?"

The simple fact is that employees earn their pension benefits, and contributions to plans are made in lieu of direct compensation. Pension benefits are no longer a reward, but a right, and the employee is entitled to the benefits of that right. Lower wages that the employee accepts now are offset by future expectations of increased retirement security. Private pensions are a necessary supplement to Social Security, and AARP believes that tax and pension law should move towards expanded benefits and coverage under the private pension system in order to achieve a more adequate retirement income. (Currently, about 20% of elderly persons are below or within $1,000 of the poverty level, and only about 25% of older persons actually receive pension benefits.)

Since plan assets are actually employee earnings, public policy should dictate that the raiding of excess pension funds for the sole benefit of the employer at the expense of participants and beneficiaries is unfair and contrary to the very purpose of pension plan funding. Especially questionable are those loop- holes in the law that foster actions that should have no place in pension funding. For example, United Air Lines recently announced it plans to recapture $962 million dollars of excess pension funds. Part of the reason for this recapture, according to a United Air Lines official, is to send a "clear message" that takeover bids for the purpose of recovering the excess assets will no longer be viable. This is not an isolated situation. The current legal exception allowing pension fund recapture has led to corporate raiding merely to gain access to pension fund money. This in turn has led to plan terminations by companies merely wishing to avoid potential takeover bids. Additionally, plan terminations have been undertaken simply to recapture funds to finance corporate ventures or to entrench present management. This is a far cry from plan terminations out of business necessity.

This new abusive pattern of terminations clearly ignores the needs of plan participants and disregards the rights of the real contributors to pension plans--the employees.

In addition, as a result of skimming off the "cushion" of assets that currently exists due to the positive affect of market forces, any new plan that may be created will have no buffer against future plan losses. This will increase the likelihood that the plan may be underfunded in future years, again threatening the retirement income security of future retirees. The integrity of the defined benefit system requires not only the continued existence, but also the assured sound funding of defined benefit plans.

There is also the potential adverse impact on the already financially burdened PBGC, which could be liable for potential future plan shortcomings which may occur after excess assets from prior plans have been drained. Another basic concern is the process by which these surplus assts are created. Questions exist involving the characterization of allowable excess assets as "actuarial error." The planned funding levels may be a source of tax manipulation and abuse.

In the face of this recent trend of terminations for the purpose of recouping surplus assets, and the accompanying adverse affect upon plan participants, it is clear an immediate moratorium is essential. Legislation is then needed to put a halt to terminations that do not take into account the needs and expectations of employees and retirees, and which assures workers and retirees of their full pension rights.

STATEMENT OF UNITED AIRLINES
BEFORE THE
HOUSE SELECT COMMITTEE ON AGING
AND THE
SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

June 12, 1985

United Airlines appreciates the opportunity to submit this statement for the record on the subject of United's announcement that it is transferring excess assets from United's pension plans to a trust devoted to the company's expansion program.

Government-approved guidelines allow United to recapture the excess assets only after the accrued benefits of all active and retired employees are covered by annuities.

All employee benefits will remain intact. No one will receive anything less than they would have if this transaction had not occurred. United will purchase annuities for all of its eligible active and inactive employees, including retirees. In addition, all eligible employees will become vested in their accrued benefits under the retirement plans immediately. The existing plans, which will continue to cover active employees, will not be terminated. Future benefits will continue to be funded by the company as in the past.

As a result of this action, United's employee retirement plans will not only continue to be funded by the company, but the accrued benefits will be backed by annuities purchased from major insurance companies. In addition, employees with less than 10 years of service will obtain immediate vesting in their accrued retirement benefits, which they would not have received until after their tenth anniversary.

We know of no effort to seek control of UAL, and we believe many investors have sound reasons for buying UAL stock. However, in recent weeks there has been a great deal of activity in UAL, Inc. stock and, therefore, we believe it is prudent to thwart any potential takeover interests now. Under-utilized assets like those in our pension plans might attract those who would see the excess as a source to pay off their own takeover of UAL.

Therefore, we are taking this step so that outsiders who might be tempted to try a takeover of the company to obtain those excess assets in our pension program will clearly understand that they are not available. We intend that this action, along with UAL's announced intention to sell Westin Hotel property and the UAL shareholder-authorized increase in the number of outstanding shares, will be a clear message that UAL and its companies intend to maintain control of their funds for the benefit of their employees, their future, and UAL's shareholders.

Unlike the outsider who would use those excess assets for the sole purpose of gaining control of the company, United will invest these excess funds to build the company's future. Accordingly, United will place the excess assets, after paying applicable taxes, in a trust that can be used only for funding its corporate expansion. Examples of such expansion are the recently-announced purchase of 25 Boeing 737's from Frontier Airlines and the planned acquisition of the Pacific Division of Pan Am.

Recapturing these assets is a vital investment in our company's future and our efforts to build United Airlines. This action will strengthen United and UAL financially and will provide a more accurate reflection of our financial position.

Both our employees and UAL shareholders will benefit from the financial stability this action will provide us. United will devote these funds to expanding the airline and that will mean more jobs, more job security, and more advancement opportunities for our employees.

STATEMENT OF CAPTAIN HENRY A. DUFFY, PRESIDENT, AIR LINE PILOTS ASSOCIATION

The Air Line Pilots Association appreciates the opportunity to present this statement to the Select Committee on Aging and the Subcommittee on Labor-Management Relations. ALPA represents 34,000 pilots, who fly for 49 airlines, for purposes of collective bargaining under the Railway Labor Act. We commend the Committee and the Subcommittee on your interest in, and desire to reform, the process of defined benefit pension plan terminations involving the reversion of so-called "excess" assets to the employer.

Since 1982, ALPA members have been involved in four defined benefit plan terminations involving an amount of plan assets in excess of that claimed to be needed to purchase participants' and beneficiaries' accrued benefits as of the date of plan termination. Of these four, the first two were products of collective bargaining, with the negotiations occurring prior to the release, in April 1984, of the Administration's "Implementation Guidelines" on plan terminations involving reversions. In addition, they were complete terminations, involving no ongoing plan, as would be the case in a "spinoff-termination," or mirror plan, as would be the case in a "termination-reestablishment." The other two plan terminations involving reversions were not collectively bargained, but are being pursued unilaterally by the employers. They also constitute spinoff-terminations, and were not concocted until after the release of the Administration's Guidelines.

ALPA does not believe that it is a mere coincidence that the terminations initiated prior to the issuance of the Guidelines were collectively-bargained complete terminations while the terminations announced after the issuance of the Guidelines are unilateral spinoff-terminations. ALPA opposes the issuance of the Guidelines themselves, as well as the spinoff-termination and termination-reestablishment techniques authorized by them. Brief descriptions of the four cases are helpful in understanding ALPA's position.

In 1982, Western Air Lines was on the brink of insolvency. In the face of stiff competition, its losses were tremendous and increasing steadily. As part of a package of concessions, the pilots agreed to accept a substantial wage cut. In addition, Western sought termination of the pilots' defined benefit plan. The termination would relieve Western of the plan's funding costs and would permit Western to recoup tens of millions of dollars in "excess" assets, which could be used to keep the business from going under. The alternative to the plan termination with reversion may well have been the total loss of the airline and consequent loss of pilot jobs. The pilots agreed to the plan termination, effective December 31, 1982, and since that date, Western has made a substantial comeback. This turnaround may not have been possible without the negotiated termination of the pilots' plan.

The second case involves the pilots of Republic Airlines. Republic, too, has been suffering in the wake of airline deregulation. In 1983, the Company asked the pilots to agree to concessions involving, among other things, termination of their defined benefit plan. Pilots' defined benefit costs at Republic had been rising and in addition, the plan was operating under funding waivers for its 1981 and 1982 plan years. In an agreement reached in March 1984, the pilots agreed to termination of their defined plan, and wiped these liabilities off the Company's books. However, the pilots successfully negotiated that any assets of the plan which were in excess of those needed to purchase the previously-negotiated level of benefits would be used to increase benefits, and would not be used for non-pension purposes. The Company's goal was not to recapture "excess" plan assets but was to eliminate its ongoing and heavy funding liability to the plan, which made corporate borrowing extremely difficult. As with Western, Republic has experienced a turnaround in recent months.

The examples at Western and Republic represent the negotiated endings of two defined benefit plans which had negotiated beginnings. These terminations had nothing whatever to do with the Administration's Guidelines on reversions, issued subsequently, in April 1984. They were neither suggested nor prompted by the Guidelines. Rather, these terminations were the direct product of collective bargaining, and as such, were terminations with which the participants and beneficiaries were more comfortable, as they participated fully in both the decision to terminate and the implementation of that decision.

In sharp contrast are the pilot pension terminations proposed by Frontier Air Lines and United Air Lines. These proposals were made after the Guidelines were issued. But for the issuance of the Guidelines, it is evident that these spinoff-terminations, involving in each case collectively-bargained plans, would not have been pursued.

On December 21, 1984, Frontier Air Lines filed with the PBGC for approval of spinoff-terminations involving all of its defined benefit plans. The sole purpose of the spinoff-terminations is to recoup the plans' so-called "excess" assets. In a spinoff-termination, the plan is split into two plans, one for active employees and one for the retirees. The retiree plan receives all the plan's assets above that needed to purchase annuities to cover the active employees' accrued benefits as of the date of termination of the retiree plan, leaving the ongoing plan with no funding for benefits earned after that date.

The potential harm to a plan from the removal of the funding cushion under this approach has become a reality with the Frontier pilots' plan. Subsequent to the proposed plan termination date of December 31, 1985, the plan has experienced a significant increase in disability retirements. Under the plan, a participant's disability retirement benefit is much higher than his normal retirement benefit accrued as of the same date, making the cost of providing a disability retirement benefit greater. The cushion in the pilots' plan exists partially to fund these disability benefits. However, if the PBGC approves the spinoff-termination as of December 31, 1984, with the entire funding cushion going to the Company, the ongoing plan will be left with not one cent to pay that portion of the disability benefits which exceed the accrued benefits as of December 31, 1984.

We do not believe it is appropriate for the Administration to sanction the reversion of pension monies to the employer, especially in cases such as the Frontier pilots' plan, when a marked increase in ongoing plan liabilities is known with a certainty. Even in cases where it is not known, the likelihood of such an increase exists, either because death and disability benefits exceed accrued benefits or because benefits are improved. Legislation is needed to limit the availability of a technique which permits an employer to raid a pension plan's assets and leave the previously strong plan teetering on a pay-as-you-go basis. In Frontier's situation, the reversion would occur in the face of very open and explicit statements by members of the Company's management and Board of Directors that the Company may not be able to survive but may be forced to liquidate. A serious inequity exists if a financially-troubled plan sponsor can raid the pension plan and then liquidate, leaving plan participants with lesser pension benefits than were negotiated, in the case of a collectively bargained plan, or otherwise promised, in the case of a "unilateral" plan.

Economic conditions, in general, are too volatile to make the security of retirement benefits subject to the future financial success of the plan sponsor, if this situation can be avoided. Economic conditions in the airline industry are particularly volatile. ALPA is all too familiar with the granting of funding waivers to our members' employers. Thus, regardless of the present financial standing of the employer, funding of benefits should not be subject to optimistic speculation about the future financial capability of the employer. Skimming off so-called "excess" assets involves precisely such a speculation.

The fourth case is well-known to this Committee and Subcommittee, and involves the pension plan of the pilots at United Air Lines. On June 11, 1985, one day before your joint hearing on this subject, United announced its intention to recover the largest pension asset reversion in history. The estimated reversion is extraordinary--$962 million. The actual recovery would likely be higher, far in excess of $1 billion, based upon the differences between the interest rate and other variables assumed in estimating the amount, and those actually prevailing in today's annuity market.

Again, the tactic being pursued is the spinoff-termination technique authorized by the Administration's 1984 Guidelines. The Company's announced goal in removing this colossal amount of pension plan assets is to prevent a hostile takeover attempt. United admits it knows of no entity seeking control of the company. Even so, United would perpetuate its present management against this unknown invader coming in and raiding its pension plans, by perpetrating the raid itself.

The United plan reversions are to be placed in an "irrevocable trust" intended for corporate expansion. The concept of an "irrevocable trust" was drummed up to emphasize the safety of the pension money. ALPA cannot understand how the Company can expect employees to believe that the employees' pension money is safer in the Company's "irrevocable trust" than it is in the employees' pension trust.

In addition to unannounced ventures, the Company intends to use this "irrevocable trust" money to close deals on the purchase of twenty-five or thirty aircraft from Frontier Air Lines and the purchase of Pan American World Airways' Pacific Division. It appears that these deals may have been negotiated with the prospect of obtaining the purchase money from United's pension plans. If this is found to be true, a breach of ERISA's fiduciary duty provisions will have occurred. The Department of Labor says that the decision to terminate a pension plan, in and of itself, is not subject to ERISA's standards of fiduciary duty. This position is doubtful, at best. But even if it is accepted as given, these standards of fiduciary duty, nevertheless, apply to all facets of the events leading up to the decision to terminate, as well as to the implementation of that decision. These standards would prohibit a fiduciary from removing plan assets for the express purposes of preventing a corporate takeover and financing corporate expansion. If an independent fiduciary would not be permitted to take this action, why should the employer be permitted to do so?

These four cases point up some of the issues inherent in plan terminations involving reversions to employers. We have specific recommendations on how to deal with some of these issues.

1. A plan which is established or maintained pursuant to collective bargaining should be terminated by the same process. It is a basic truth worth repeating that collectively-bargained pension plan contributions are made in lieu of the payment of direct wages to the covered employees. Since the monies in the plan represent deferred wages, in the event of a plan termination, any "extra" monies in the plan should be used to benefit participants, and should not be devoted to non-pension corporate purposes, in the absence of a collectively-bargained agreement providing some other mode of settlement.

2. Congress should rescind the Administration's 1984 Guidelines and address the issues raised therein by legislation. These Guidelines were issued

without following the regulatory process established by the Administrative Procedures Act. The Administration determined that this process did not have to be followed since, as Mr. David Walker's written statement to you indicates, the Administration believes the Guidelines represent merely an "informal summary of the principles of current law applicable to reversions." If that was the Administration's intent, we do not believe they summarized ERISA and the Internal Revenue Code very well. These laws require that qualified plans be operated for the exclusive benefit of participants and beneficiaries. The use of the term "exclusive" was intentional. These laws never intended that employers be permitted to withdraw huge sums of money from their pension plans to further non-pension corporate purposes. Furthermore, the longstanding position of the IRS, as stated in its official regulations, is that a plan termination will not be recognized if a comparable plan is established in its wake. It is difficult to see how the Guidelines, issued in the form of a joint press release, can overturn this basic tenet.

3. A different definition of "excess" assets must be established. Under present agency interpretation, pension plan assets are considered "excess" and ripe for reversion to the employer if they exceed the amount needed to purchase "accrued benefits" determined as of the date of the termination. However, in the case of a spinoff-termination or a termination-reestablishment, this process does not adequately take into account the needs of the ongoing plan for active employees. Retirement benefits in many ALPA-negotiated plans are calculated as a percentage of a pilot's final average earnings, using the highest three, four, or five years of earnings as the basis for determining the average. Thus, under these plans, the vast bulk of a pilot's retirement benefit is earned at the end of his working career, when his earnings are the highest. With increasing numbers of normal retirements, plan liabilities are

rising sharply. When the ongoing plan is stripped of its funding cushion in midstream, especially when plan liabilities are at their highest level, higher employer contributions will be required in future years to make up the resulting funding deficiency. These contributions will far exceed those which would be required if the so-called "excess" were simply left in the plan. There is no guarantee that the employer will be able to make the larger contributions in the future. The employer might then be forced to file for a funding waiver or terminate the ongoing plan, or even file for bankruptcy or liquidation.

4. A directive to enforce Section 4044(d)(1) of ERISA must be given to either the PBGC or the DOL. This Section provides that excess assets may revert to the employer if:

(A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such a distribution in these circumstances.

Although the requirements of paragraph (A) are determined by the PBGC, and the requirements of paragraph (C) are easily verifiable, the requirements of paragraph (B) are not so well-defined. In the case of the spinoff-termination involving the pilots of Frontier Air Lines, ALPA presented evidence to the PBGC and the DOL of violations of ERISA, the Internal Revenue Code and the Railway Labor Act. Such contraventions of law, if proved, would cause the reversion to be prohibited under Section 4044(d)(1)(B). However, the PBGC and DOL have taken the position that the employer has an unfettered right to terminate a pension plan involving a reversion. It is evident that the protective intent of Section 4044(d)(1)(B) of ERISA has been lost in the decade since its enactment.

5. Spinoff-terminations and termination-reestablishments should be prohibited in recognition of the questionable nature of the termination and the increased liabilities foisted upon the ongoing or successor plan. These liabilities translate into potential PBGC liability, as well as potential benefit losses to participants. If such transactions do receive legislative approval, however, even negotiated spinoff-terminations and termination-reestablishments should not permit the recovery of a reversion all in one year. Rather, the recovery should be made over a fifteen-year period, since it is only over such a length of time that the firm funding status of a plan, and the continued viability of the plan sponsor, can be established with any comfort.

Obviously, reform in the area of pension plan terminations involving asset reversions is critical. Private pension plans are established to provide a measure of economic security for millions of employees in their retirement years. It should not be the business of this Administration to jeopardize the future welfare of these millions by encouraging, in fact, enticing, plan sponsors to engage in questionable transactions involving the assets of these plans.

ALPA stands prepared to provide this Committee and Subcommittee with whatever assistance is required to curb the abuses inherent in pension plan terminations involving asset reversions.

STATEMENT OF JEREMY BULOW, STANFORD BUSINESS SCHOOL

The Termination of Overfunded Pension Plans

The issues I will deal with in my testimony are:

I. How and why did numerous corporate pension plans become overfunded?

II. What kind of workers are most likely to be in overfunded plans?

III. Why might companies terminate such plans?

IV. How are workers affected by withdrawal of excess assets, and

V. What if any policy moves might Congress consider?

I. First, how and why did pension plans become overfunded? There are two ways. Number one, the actuarial methods that firms may use in funding pension plans allow them to sock away extra money in a tax free account, beyond what is needed to cover their pension obligations. Wealthy companies like IBM have tended to contribute as much as possible to their plans, with the view being that the excess above what was earned by the workers would earn interest for the company at a tax deferred rate. Thus, by allowing companies to overfund their plans the government allows these companies to have the equivalent of a corporate IRA plan. The company gets an immediate deduction, like the IRA contributor, earns interest at the tax free rate, and can use the interest earned on the excess to reduce future pension costs. Alternatively, if the company finds itself in a situation where it is in a low tax bracket it can withdraw the excess funds either by completely eliminating pension contributions for a few years or terminating the plan and taking out the extra money. The main differences relative to an IRA are (1) you can put away a lot more than $2000 and (2) there is no penalty for withdrawing the money, comparable to the 10% early withdrawal penalty of IRAs.

The second reason plans have become overfunded is because of luck--the good stock market performance of recent years combined with high long term interest rates. Many plans had assets and liabilities approximately in balance at the time of the passage of the Pension Reform Act of 1974. Since that time the stock market went up, increasing the value of plan assets. Also, long term interest rates went up. This reduced the value of bonds held as pension assets, but mainly it reduced the value of pension benefit promises. The reason is that pension obligations are very long-term in nature: A 50 year old worker may have a pension benefit that involves payments only starting 15 years hence. This long term nature makes pension benefits super-sensitive to interest rates. I estimate that an increase in long term rates from 7 to 11 percent reduced the present value of pension obligations by about a third.

Thus, (1) companies have a tax incentive to overfund plans; (2) the good stock market raised the value of pension plan assets and thus increased overfunding, and (3) the increase in interest rates reduced the cost of buying annuities to fund pension liabilities--that is, reduced the present value of worker benefits, further increasing the disparity between assets and liabilities.

In a study widely quoted in the business press several years ago, I estimated that by 1980 the degree of overfunding approached $50 billion, thereby making some excess terminations likely in the coming years. The amount of overfunding has surely gone up since that time. II. What kind of workers are most likely to be in overfunded plans? We are mostly talking about salaried employees. For a number of reasons not crucial to this subject, union plans (multiemployer as well as single-employer such as the UAW arrangement with GM) do not tend to be overfunded. Companies that have done well enough financially to be consistently paying taxes have had the most incentive to overfund. As you might guess, IBM has the most overfunded set of pension plans.

III. Why might companies terminate such plans?

The primary reasons for terminating an overfunded plan are as follows:

(1) The firm's tax situation may have changed so that overfunding to postpone taxes is less important. A large number of terminations of overfunded plans are by firms who are not currently paying much if any tax.

(2) The firm is in financial distress that makes it difficult to raise money externally. It raises money by liquidating parts of the business that can be relatively easily severed from the operation. Liquidating a pension portfolio is easier than selling a finance subsidiary.

(3) The company decides it would prefer a defined contribution pension plan. Reasons for preferring a defined contribution plan are:

(1) Simplicity. Every employee knows what he or she has in the plan, and the firm finances all liabilities as they accrue.

(2) With a defined contribution plan two workers earning the same salary will accumulate the same pension benefit. With a defined benefit plan benefits are severely backloaded to older workers. Because of age discrimination laws employers may find it difficult to give younger workers higher salaries to balance their lower pension benefits. Therefore, if the firm wishes to give equal pay for equal work it may prefer a defined contribution plan.

(4) Employees may prefer a defined contribution plan. If so, by granting a defined contribution plan and thus providing employees with a more highly valued benefit, the company may be able to hire workers at lower total cost. Professional economists tend to think that defined contribution plans would dominate the corporate scene were it not for some of the tax advantages of defined benefit plans.

IV. How are workers affected by the withdrawal of excess assets?

They are directlly affected in that all benefits accrued but not yet vested become immediately vested. This is a plus for workers.

The minus side occurs when, in a partial plan liquidation, employees find their benefits, which previously had the protection of the excess assets, are not as well protected. In the case of a partial liquidation, where currently retired workers are "spun off" into a separate plan with the excess assets and that plan is terminated, the current workers will find that their benefits which have been accrued but are not guaranteed--such as benefits above the guarantee limit, death benefits, other benefits besides straight pension benefits, benefits due to any recent plan amendments, and any accrued but non-vested benefits--are all at greater risk.

For example, if a firm withdrew its excess assets and then interest rates fell it would not have enough assets to cover all its liabilities. This would lead to nonpayment of accrued but not guaranteed benefits in the event of a subsequent termination. If assets fell below the level of guaranteed benefits, then the PBGC might get caught having to make up the difference.

One way in which workers are not affected by terminations of overfunded plans is by an effect on ad hoc benefit increases of retired workers. Firms can pay or not pay such increases as they so desire. Perhaps firms which terminate overfunded plans will not pay out ad hoc benefit increases, but if not it is unlikely that they would use the excess funds to pay ad hoc increases rather than reduce future pension contributions anyway.

V. Finally, what can or should the government do about overfunded plans and the termination of overfunded plans? Some have argued that because the increase in inflation and interest rates have decreased the value of pensions, creating windfall losses for workers and equivalent gains for firms that workers should be given substantial rights in the excess assets from any termination.

I disagree for two reasons. First, as a fairness issue I don't see why the holder of a pension annuity should be treated differently than a bondholder. If some middle income person bought long-term 7 percent government bonds in the early 70's to save for their retirement, the federal government does not make up any losses they have suffered on the issue. The owner of a pension annuity is just a holder of a special kind of long term fixed dollar corporate obligation and will gain if interest rates fall and will lose if interest rates rise.

Second, a ruling which required firms to pay out to workers some substantial fraction of excess assets would simply lead firms to drain excess assets in a variety of other ways, the simplest being to reduce future pension contributions.

There are two items on which Congress might act, however. One, as I said, the spinoff of the excess assets in a continuing defined benefit plan reduces the safety of worker claims and increases the likelihood of a PBGC payout. Plans which have assets below or barely above accrued benefits should have their investment policies monitored so that they don't add risk to the firm's ability to pay out accrued benefits. The way to do this would be by requiring firms to hedge their pension assets and liabilities sufficiently to avoid shortfalls. For example, the FDIC monitors banks and ideally checks that assets and liabilities are well matched so that changes in market conditions will not put a lot of banks under. Similarly, the PBGC should demand that firms with pension assets close in value to their liabilities immunize themselves from market risk by buying long term bonds to hedge the long term pension liabilities. On the other hand, as a plan holds more excess assets it should have more freedom in its investment decisions just as the FDIC can give more freedom of investment policy to a well funded bank like J. P. Morgan than it can to Continental Illinois. For example, IBM's pension is so overfunded that benefits are safe regardless of what the assets are invested in, and there is no reason to put limitations on IBM's investment policy for the purposes of benefit safety.

Finally, I think some closer scrutiny must be given to the issue of how defined benefit and defined contribution plans are taxed. A disadvantage of defined benefit plans, because in reality they provide fixed nominal benefits even to workers with benefits tied to final salary, is that they force the firm and the worker to make a bet on interest rates. (This is not all bad, in that a worker may find his fixed nominal pension and fixed nominal mortgage balance nicely, and leave him hedged against interest rate changes.) However, because of the big tax advantages of a defined benefit plan firms will often use such plans and overfund them. Some serious thought should be given to eliminating the artificial distinctions between defined benefit and defined contribution plans and putting them on a equal footing for tax and other legal purposes. I hope that at some point in the future this committee will look into the integration of the various types of private pensions so that the tax and other legal distortions that currently enter the choices of type of pension, pension funding, and pension investment policy will be eliminated.

Jeremy Bulow
Stanford Business School
June 12, 1985

AMERICAN ACADEMY OF ACTUARIES

STATEMENT FOR THE RECORD

AMERICAN ACADEMY OF ACTUARIES
PENSION SUBCOMMITTEE ON PBGC (SINGLE EMPLOYER PLANS)

TO THE LABOR-MANAGEMENT SUBCOMMITTE,
HOUSE COMMITTEE ON EDUCATION AND LABOR

AND TO THE

HOUSE SELECT COMMITTEE ON AGING

OVERSIGHT HEARINGS ON OVERFUNDED PENSION PLANS

JUNE 12, 1985

The American Academy of Actuaries appreciates the opportunity to comment on the subject of overfunded pension plans and asset reversions. The issue of termination of retirement plans and asset reversion is an important one to the members of the Academy. We appreciate the opportunity to offer comments on this important subject.

The Academy is a professional association of over 7,800 actuaries involved in all areas of specialization within the actuarial profession. Included within our membership are approximately 85% of the enrolled actuaries certified under the Employee Retirement Income Security Act of 1974 (ERISA), as well as comparable percentages of actuaries providing actuarial services for other employee benefit plans such as life, health, and disability programs.

Our comments relate specifically to The Plan Termination and Reversion Control Act of 1985, H.R. 6404, introduced by Chairman Roybal. Our discussion of that bill also includes comments applicable to the general subject of plan terminations and asset reversions.

Our first concern is an issue of major importance to actuaries: specification of actuarial assumptions and methods. Section 8 of the bill calls for a study to be completed by the Joint Board for the Enrollment of Actuaries ("Joint Board") relative to the development of "reasonable actuarial assumptions and methods, for each of the various types of pension plans, which are appropriate for use by enrolled actuaries and others under this act and in the Internal Revenue Code of 1954 (IRC) in determining the actuarial status and funding requirements of such plans." This section goes on to require that upon completion of the study, the Joint Board shall "prescribe by regulation appropriate actuarial procedures for determining, for each type of plan, the appropriate actuarial assumptions and methods referred to in paragraph (1)."

The development of a single set of actuarial methods and assumptions for developing actuarial present values to be used in asset reversion situations is of serious concern to the actuarial profession. Actuaries are professionals who, through training and experience, have developed the judgement required to establish actuarial assumptions under a wide variety of circumstances. Actuarial assumptions for retirement plans will vary substantially by industry, by geographic region, by individual company, by investment and compensation policies, and so on. It would be extremely difficult for the

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Joint Board to develop standards relative to actuarial assumptions which are appropriate "across the board." Actuarial assumptions which do not appropriately reflect the experience of a particular plan might very well distort the results of an actuarial valuation of that plan. If a plan is terminating, the results of the actuarial calculations involved are so important that they should not be subjected to such potential and likely distortion.

The Joint Board is currently authorized to discipline enrolled actuaries. Actuaries who abuse the prerogative currently provided them in federal law to establish appropriate assumptions can be and are dealt with through this procedure. Furthermore, Academy members are subject to an extensive code of professional conduct and standards of practice, which is also enforced with a disciplinary mechanism. We believe, therefore, that it would be a serious mistake to establish actuarial methods and assumptions which in any way attempt to impose uniformity.

With regard to the general policy of H.R. 6404, we believe that of equal importance to the problem of the termination of overfunded plans is that of the termination of underfunded plans and the resulting obligation assumed by the Pension Benefit Guaranty Corporation (PBGC). In many respects, the actuarial implications of both underfunding and overfunding are similar. All plans must be funded in accordance with the provisions of Section 412 of the IRC. On one hand, compliance with the IRC can result in underfunded plans; on the other hand, it can also result in overfunded plans.

Current IRS funding regulations permit use of a range of accepted actuarial cost methods. Legislation which limits or inhibits the ability of a company to recapture excess assets could result in plan sponsors electing to use actuarial cost methods which will develop minimum contributions. This could exacerbate the problem of plans terminating with insufficient assets. We believe that few, if any, plan sponsors establish plans with the intent to terminate them at a subsequent date and recapture excess assets that have accumulated tax-free. However, if circumstances result in surplus assets and plan sponsors perceive that penalties are invoked on the return of the excess monies, this could in turn affect critical funding decisions.

The concept of actuarial surpluses and attendant asset reversions is often misunderstood, and yet it is a concept at the core of H.R. 6404. Many actuarial cost methods which are acceptable under the IRC result in the development of a pension fund which exceeds the liability for benefits accrued up to a point in time. The cost per dollar of benefit increases as an employee's age increases, because the period in which funds accumulate prior to the date benefits commence is shorter. However, the most commonly used actuarial cost methods are structured to develop a pattern of costs which will be level as a percent of payroll, or a level dollar amount per covered participant in plans in which benefits are not based on pay. In order for costs to be level, amounts greater than that required to fund the benefits accruing in early years must be then contributed. As the employee ages, the contribution is less than the amount required to fund the benefit accruing each year. The excess contribution from earlier years enables the plan to meet its benefit obligations.

In plans where benefits are based upon average pay at or near an employee's retirement or termination of employment, future pay increases are usually anticipated in the funding. This results in an even greater increase in costs relative to benefits accruing in the earlier years. For example, an employee currently making $10,000 may be projected to receive pay increases so that his pay at retirement will average $20,000. If the benefit formula provides 1% of pay for each year of service, the benefit which accrues while the employee is at the $10,000 level is $100—1% times $10,000. For funding purposes, the actuarial method and assumptions will project a rise in pay to $20,000 and fund towards a benefit which represents 1% of $20,000 per year or $200. Current IRS funding requirements mandate funding towards this projected higher benefit level.

For the typical plan, after a period of years, the assets in the fund may exceed the liability for benefits accrued to date by 25% to 75% if the plan were then to terminate. If the company continues in business and the plan is continued, those assets will ultimately be needed to pay benefits. However, there are several circumstances in which assets in the fund will accumulate to amounts in excess of those required to pay benefit payments. Examples of some are as follows:

- Employees terminate more rapidly than projected by the actuarial assumptions.
- An unanticipated reduction in staff occurs because of changes in the employer's business and/or general economic conditions.
- The actuarial cost method is changed to one which results in a lower incidence of cost.
- Fund investment results are more favorable than those anticipated.

In each case above, the higher funding which occurred in earlier years is not necessary to pay benefits in later years. The actuarial methods acceptable under IRS regulations adjust for these excess funds in various ways. Generally, all recognize them through reduced contributions over approximately a 15-year period.

At present, the IRC permits an employer to recapture any excess funds only when a plan is terminated. If gains occur for several successive years, 15-year spreading can mean that surplus funds continue to increase. In an extreme case, continuing gains could result in a fund projected to grow forever. This may lead an employer to consider terminating a plan or spinning off and then terminating a plan. This is an expensive and administratively cumbersome series of steps. If asset reversions are to be permitted, consideration should be given to simplifying the procedures.

Concern has been expressed that the recaptured amounts may not be subject to income taxes because the company has several years of tax losses, even though at the time the contributions were made they were deducted from the employer's taxable income. In a typical pension fund, all plan assets are fungible so that it is practically impossible to trace amounts to their historical origins (date at which they were made). There are several ways, however, in which this can be approximated. We believe that in most approximations, the surplus assets would be identified as those contributed in the past few years. By applying the average (or marginal) tax rate over a period, such as the past ten years, and adjusting for investment return, a tax rate applicable to the amount of reversion could be developed which would be the actuarial equivalent of the previous deductions.

Where a substitute plan is established for a plan being terminated, greater contributions will be required in the future than if the asset reversion had not occurred. There are several acceptable actuarial techniques to assist companies in funding of such pension plans. These can identify a date in the future at which the surplus would have been "used up" had the plan continued. These methods, however, are generally not approved by the IRS as acceptable funding methods. Such methods, with appropriate parameters, can nevertheless reflect the facts and circumstances of each individual plan, and may be more useful in protecting the interest of plan participants against adverse consequences of a future plan termination where assets are insufficient to meet liabilities.

While the subject of plan terminations and asset reversions is under consideration, we are aware that revisions in Title IV of ERISA are currently being addressed. At the appropriate time, the Academy will comment on any resulting proposals that may be introduced. Perhaps these two questions could be addressed simultaneously, so that symmetry can be achieved between the treatment of terminating plans with insufficient assets and those terminating with asset reversions.

We hope this information is useful to you. If we can answer any questions or provide additional information, please let us know.

Norman S. Losk
Chairman, Pension Committee

Darrel J. Croot
Chairman, Subcommittee on PBGC
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Edward N. Fleischer
James A. Gobes
Marc M. Twinney
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June 12, 1985

Statement of

William S. Hoffman, Ph.D.
Director, Social Security Department
International Union, UAW

on the subject of

REVERSIONS OF "EXCESS ASSETS" TO EMPLOYERS FROM TERMINATED PENSION PLANS

before the

Select Committee on Aging
and the
Subcommittee on Labor-Management Relations,
Committee on Education and Labor
United States House of Representatives

On behalf of:
International Union, United Automobile,
Aerospace and Agricultural Implement
Workers of America (UAW)

Mr. Chairmen, I am William S. Hoffman, Director of the Social Security Department of the International Union, UAW. The UAW appreciates the opportunity to present its views to the Select Committee on Aging and the Labor-Management Relations Subcommittee concerning the reversion of "excess assets" to employers upon the termination of defined benefit pension plans.

This statement is submitted on behalf of the more than one and one-half million active and retired workers who are members of the UAW. Our Union has been negotiating defined benefit pension plans (establishing and improving them) for 35 years, because in our judgement they represent the best means of providing adequate retirement income security to our members. The vast majority of our members are now covered by defined benefit pension plans, either earning future retirement security as active workers or receiving monthly benefits as retirees. We therefore have a keen interest in retirement policies which foster the growth of defined benefit plans, and we are profoundly disturbed by the fact that hundreds of defined benefit pension plans have been terminated in the last few years by employers intent on expropriating so-called "excess assets" from those pension plans. The UAW strongly believes that there is an urgent need for legislative action to stop such abuses, and we commend these Committees for holding hearings on this important subject.

Just over a year ago, we testified on this same subject before the Subcommittee on Labor, of the Senate Labor and Human Resources Committee. At that time 162 defined benefit plans had been terminated in the preceding four-year period involving reversions of about $1.1 billion in "excess assets" to employers. The situation has drastically changed for the worse since that time, according to the Pension Benefit Guaranty Corporation (PBGC), which has been monitoring reversions of $1 million or more. PBGC now reports that, in the period from May 31, 1980 to March 31, 1985, employers have terminated some 435 defined benefit pension plans covering more than a half million people, and have seized over $3.9 billion in so-called "excess assets". It is astonishing to note that the value of the reversions in these 435 cases was almost equal to the present value of the benefits payable to plan participants as of the termination dates (about 93%). If the reversions had not been allowed, the amount of funds available to provide protection to workers and their families would have been nearly doubled. The reversions to date represent a loss of almost $7800 for each participant. It should be noted that these statistics do not count reversions of fewer than $1 million, and therefore understate the magnitude of the problem. This raiding of funds earmarked for pension benefits is especially outrageous in those cases where the participants had their benefits frozen at low levels, but continued working for the employer. The employer has stopped the pension clock for these workers while, in most cases, their service continued and their need for future pension benefits continued to grow.

The PBGC has also reported that as of April 10, 1985 there were pending 200 pension plan terminations involving potential reversions to employers of $1 million or more. When these pending cases are resolved, another $2.3 billion will revert to employers, and some 282,407 plan participants will be adversely affected. The per capita loss for those workers and retirees will be greater than $8,000. Moreover, for those of us who are convinced of the overwhelming superiority of defined benefit pension plans, it is alarming that in only 50 of the 200 cases pending before the PBGC has the employer indicated an intention to establish a successor defined benefit plan. In another 33 cases, no successor plan is anticipated even though the business is expected to continue.

The UAW commends Congress for instructing the PBGC to monitor termination-reversions. All of the evidence gathered to date indicates that this problem has gotten a lot worse very quickly. Legislative remedies are urgently needed. The UAW therefore calls on Congress to move expeditiously to enact legislation which will prohibit the reversion of so-called "excess assets" to employers upon the termination of a defined benefit pension plan, except in cases where the termination is prompted by compelling business necessity. In those instances of demonstrable "business necessity", Congress should limit the reversions to employers to half of the "excess assets". These reforms would effectively insulate pension funds from employer attack in most cases, but would still recognize that some sharing of the "excess assets" with an employer may be justified in cases of compelling business hardship in order to keep the employer viable and to help preserve jobs.

The UAW recognizes that the private pension system in the United States is a voluntary system. Nevertheless, we submit that once an employer has established a defined benefit pension plan, the employees have a legitimate expectation that they will continue to accrue benefits and attain eligibility for benefits promised under the plan, so long as they continue working for the employer. They also have a legitimate expectation that the employer will continue to maintain the pension plan, unless it is financially unable to do so or there is some other compelling business consideration requiring termination of the plan.

Under the provisions of the Internal Revenue Code, in order for a defined benefit pension plan to become a qualified, tax-exempt plan (such that the employer may take a deduction for any contributions paid to the plan), the employer must intend for the plan to be permanent. Congress has granted this favorable tax treatment to monies contributed by employers to defined benefit pension plans in order to further the social objective of assuring that workers will be provided with income security during their retirement years. The UAW believes that Congress should not permit employees' retirement expectations to be frustrated by plan terminations that are motivated by the desire of employers to use pension assets as a ready source of cash with which to finance corporate strategies.

The termination of a defined benefit plan, and the attendant frustration of future retirement expectations, may be unavoidable in certain situations, such as when the employer is experiencing severe economic hardship and is unable to continue funding the plan. It is an entirely different matter to permit the termination of defined benefit pension plans when the termination is not motivated by compelling business considerations, but rather is solely for the purpose of enabling the employer to recapture pension contributions. This type of abuse is particularly egregious where the employer terminates the pension plan and obtains the "excess" pension funds in order to finance corporate takeover strategies or other business transactions of questionble social value. One of the more notorious illustrations of this type of abuse involved a plan termination by Harper and Row Publishers, whose employees are represented by District 65, UAW.

We recognize that there are arguments for allowing employers to have a claim on "excess assets" under certain circumstances. For example, the absence of any such provision might cause employers to fund pension plans over a longer period of time, and thus to reduce benefit security. However, there also are strong arguments against giving all of those assets to the employer. Employers generally make compensation decisions on the basis of total labor costs, including their actual level of pension contributions. Thus, if pension contributions prove to be higher than were actually necessary to finance the plan's defined benefits — and thus produce "excess assets" — then other compensation (e.g., cash wages) probably were lower than they could have been.

Current law explicity recognizes this trade-off between cash wages and pension benefits which is a necessary part of any decision-making about compensation, whether it is in the form of collective bargaining or unilateral employer action. In an on-going pension plan, actuarial gains are amortized over a 15-year period, thus freeing up more money for other forms of compensation. Employers and workers thereby share in any actuarial gains under an on-going plan. As a simple matter of fairness, then, workers should also share in such gains when a plan is terminated. Where a plan provides for explicit employee contributions, current law recognizes that employees have a claim on any "excess assets"; we suggest that logic is equally applicable to all pension funds since they all involve deferred compensation. Hence, the UAW submits that the application of a general sharing formula to any "excess assets", so that employers and participants both receive a portion of the funds, represents a reasonable approach. Application of such a sharing formula would provide an effective means of reducing the incentive for employers to terminate defined benefit plans solely for the purpose of recapturing plan assets, without unduly discouraging employers from properly funding their pension plans.

I would like to describe one example of a termination-reversion situation involving a UAW negotiated pension plan, which illustrates the inequities that can arise under current law, when employers are allowed to freely terminate pension plans in order to recapture "excess assets" and are not required to share the "excess assets" with their employees.

In mid-1984, a company demanded contract concessions from one of our Local Unions during the term of the collective bargaining agreement covering a small shop with 32 workers. Negotiations were conducted over several weeks, but the parties were unable to reach an agreement. However, the company's last offer was submitted to the full membership for a vote. The membership rejected the concessionary package by a large margin. A couple of weeks later the employer closed the shop and moved to terminate the defined benefit pension plan. The plan contained sufficient assets to cover all accrued benefits for the 32 workers, which were valued at about $53,000. In addition, there were about $55,000 in "excess assets" which subsequently reverted to the employer. That represents a per capita loss of more than $1700. Within a month of the plant closing, the shop reopened under a "new" owner who happened to be the prior plant manager. He refused to recognize the Union as collective bargaining agent and rehired only those workers who had voted for the prior concessionary package.

The UAW submits that such outrageous actions should not be tolerated. Some would argue that the promise of pension benefits was fully met in this case. But this argument totally ignores the complexities of the issue. In this small shop the Union had been able to bargain a basic pension benefit rate of $9.50 per month multiplied by the worker's years of pension service. The employer's contributions were fixed at the greater of ERISA minimum funding standards or 35 cents per hour. Consider the bargaining dynamics involved here and the explicit trade-offs which the Local Union made in negotiations stretching over several years. The Union and the company clearly earmarked an amount of money for pension benefits. In so doing, other forms of compensation like wages, health insurance, etc., were smaller than they might have been. The awful result in this case was that the workers lost twice — once when the employer was able to overcharge the package of compensation for the $9.50 pension benefit level, and again when the plan terminated with all of the "excess assets" reverting to the company. This is a classic example of the asymmetry under current law, where the company can "game" the system by bargaining artificially low pension benefits and then reap the "excess assets" at termination — assets which clearly were contributed at the expense of other benefits for the workers and their families.

In this small shop retirees and workers both lost; only the company gained. The 65-year old retiree with 30 years of service will get only $285 per month (less if he or she provided pension benefits for a surviving spouse). After 10 years of moderate inflation (e.g., 4%), the real value of that monthly benefit will erode to $192 per month. Furthermore, those workers who would have continued in employment but for the company's behavior will also lose their chance to build retirement security.

The evidence gathered by the Pension Benefit Guaranty Corporation suggests that, much like our experience with this "runaway shop", the vast majority of termination-reversion cases do not involve situations where the plan was terminated by the employer for reasons of "business necessity". Their survey of employers who terminated plans and gained $1 million or more in asset reversions showed that "business necessity" — including liquidation or dissolution of the employer; closing of a subsidiary, division or plant; adverse business conditions; the plan being too costly to maintain; or bankruptcy — was the reason for the plan termination in only 111 of the 435 cases, or 26% of all cases. Moreover, these cases accounted for only 13.4% of the value of all reversions, and only 17.7% of all participants who were involved in termination-reversion cases. If one removes from the PBGC's data the cases involving arguable "business necessity", one finds that the per capita loss to retirees and active workers is almost $8200, or 38% higher than the per capita loss (about $5935) in those instances involving arguable "business necessity".

The UAW strongly believes that these abuses must be stopped. We are aware that several Members of Congress are developing solutions to this serious problem and we applaud their efforts. In particular, we believe the legislation which has been introduced by Chairman Roybal (H.R. 2701) represents a positive step towards curtailing the various abuses associated with termination-reversions. The UAW is prepared to work with the Members of these Committees and other interested parties in order to develop an effective legislative solution. As this process unfolds, the UAW submits that the following basic principles should be incorporated in any legislative remedy:

1. The reversion of "excess assets" to employers upon the termination of defined benefit pension plans should be prohibited except where the termination is for reasons of compelling business necessity.

2. Even where the employer demonstrates to the IRS, PBGC and the Department of Labor that such a termination-reversion is essential in order to maintain the business, only a partial reversion to the employer (perhaps half of the "excess assets") should be permitted.

3. In order to protect retirees against future erosion of benefits and to protect active workers whose future accruals of pension credits are halted by plan terminations, such future expected benefits should be included in the priority categories under the allocation of assets procedure which defines "excess assets". Such a change would underscore the fact that pension plans are given tax-favored treatment only insofar as they are intended to be permanent. It would also be an important step in continuing the commitment toward building future retirement security for workers and retirees.

4. Any excess assets (as redefined in paragraph 3 above) which do not revert to the employer should be distributed to all participants according to some equitable formula, such as by increasing the lifetime benefit level for everyone by an amount which can be funded by the "excess assets."

The UAW does not believe that the Administration's proposal to levy a 10% excise tax on reversions will be effective in preventing abuses. More importantly, any deterrent should contain a mechanism for sharing a fair portion of the "excess assets" with those retirees and active workers whose retirement security is being adversely affected by the plan termination.

The UAW again commends these Committees for calling attention to the serious abuses of our pension system involving the termination of defined benefit pension plans by employers in order to capture so-called "excess assets". The evidence gathered by the PBGC indicates that the magnitude of the problem has grown tremendously in the last year. We are eager to work with the Members of these Committees in fashioning solutions to the fundamental defects in current law which allow employers to terminate their pension plans, stop pension accruals for active workers, and freeze forever the benefits for retirees in situations where there is no legitimate business hardship, solely for the purpose of recapturing billions of dollars in "excess assets" for business purposes totally unrelated to the reasons for establishing the pension plans in the first place. Thank you.

opeiu494

STATEMENT OF WALTER R. NIAL, FORT LAUDERDALE, FL.

17

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Statement for Joint Hearing on "Overfunded" Pension Plan Terminations

Honorable Edward R. Roybal
Chairman, House Select Committee on Aging
712 House Annex 1
Washington, D.C. 20515

and

Honorable William Clay
Chairman, House Subcommittee on Labor-Management Relations
2451 RHOB
Washington, D.C. 20515

Thank you for this opportunity to include a statement in the record of the June 12, 1985 Joint Hearing on "Overfunded" Pension Plan Terminations.

There are several important points not brought out in the public Hearing which should be included in the record. The crucial issue of the whole subject is ownership of the money in the pension funds. This question was asked several times by a member of the Committee.

WHO OWNS THE MONEY ?

There are several aspects to this question and all of them point to the fact that the employees or the participants in the pension plans own the money. Factors supporting this view include:

1. Pensions are deferred wages and are taxed as such by the IRS.
2. Pension funds have trustees to safeguard the money for the employees and not for the company.
3. Whether the pension plan is contributory or non-contributory, the money put into the pension fund by the company is deducted as a cost of doing business, is not taxed, and does not come from profits.
4. Large numbers of employees work for defense contractors. Defense contracts include pension costs in the overhead paid by the Government. Thus, companies doing defense work do not put company money into the funds but put in money directly from the Government.
5. In many cases collective bargaining agreements specified a money settlement with a portion in immediate wages and a portion to go into pensions. The origination of most pension plans came as a result of hard collective bargaining and thus pension plans were not voluntary on the part of the employer. The monies involved are

5. (cont.) the result of employer-employee contractual agreements and not subject to unilateral, discretionary actions by the employer.

6. In contributory plans, a financial analysis of the value of the employee contributions alone and based on reasonable expected return on investment interest rates shows that the employee contributions often are sufficient to finance the total pension. For example, Mr. Arthur Wilson testified that Getty attributed 3% interest to the employee contribution up to 1978 and 5% since then. If the manager of the pension fund were only able to earn 3% interest on the fund monies, the fund manager would be fired and rightly so. Why then, is the employee money only credited with 3% interest? What should happen then is that a reasonable return on the employee contribution would be sufficient to finance the pension without any company contribution at all. Thus, all pension fund monies would be direct employee money.

SHOULD COMPANIES BE ABLE TO TAP EXCESS FUNDS

Representative Saxton raised this question and Representative Fawell expressed his opinion that employers should have access to the pension funds.

From the employees viewpoint, the employer should not have access to the pension fund monies under any circumstances. If there truly are "excess" monies in the pension fund, then the law permits employers to amortize the "excess" over 15 years but not to dip into the fund for a cash withdrawal. The law is wise in this respect because there is the possibility that the pension fund will fluctuate from year to year to being underfunded or overfunded. No one knows with certainty what the future will bring and that is why the 15 year amortization was permitted. However, if the pension fund is underfunded, the law is more liberal toward the employer and permits the employer to amortize the underfunding over 20 year. Until very recently, all pension funds were underfunded. It is only by means of risky assumptions of future interest rates that companies have been able to define their pension funds as overfunded.

There is another more compelling reason why employers should not have access to pension monies even if the employer is going bankrupt. The pension money is a safety net for the future well-being of the employee. If the employer takes money from the pension fund to avoid bankruptcy and still goes bankrupt, then the employee is not only left with no job but also no pension.

WOULD STRONGER LEGISLATION INFLUENCE THE TYPE OF PENSION PLAN OFFERED

Representative Rinaldo expressed the opinion that new legislation would hurt the employee. Mr. David Marshall expressed the opinion that the proposed legislation would frighten employers away from "defined benefit" pension plans.

The fact of the matter is that employers want to discontinue "defined benefit" pension plans as fast as possible and are doing so under the present blanket approval of pension plan terminations by the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation. Employers want to eliminate any risk for themselves by shifting to "defined contribution" pension plans or no pension plan at all. A Pension Plan Administrator for Crown-Zellerbach expressed the opinion that within five years there would no longer be any private pension plans. Corporate executives have stated that since the employee can have an IRA and a 401(k) savings plan, that a pension plan is no longer needed.

Sam Robinson, Chairman and Chief Executive Officer of Robinson Nugent, takes an even more despotic view of pensions and wages. In an article in the July 30,1984 issue of Electronic Engineering times Mr. Sam Robinson wrote, "We're currently taking too much from the productive portion of our society and handing it over to the retired portion. --The only solution, as I see it, is to phase out the Social Security system." Robinson also wrote, "We'll keep you on, Mr. Jones or Miss Smith, at age 55, but we'll have to reduce your compensation-- and if that is not satisfactory, then you have six months to look for other employment."

Stronger legislation is needed to keep the present pension plans intact. Stronger legislation will not influence the type of plan employers select for new pension plans. However, if the Administration enforced the present law as it was intended to be enforced, the need for additional legislation might disappear.

A SPECIFIC TROUBLESOME CASE

A notice in the Federal Register/Vol. 50, No. 63/ Tuesday, April 2,1985 described the application by the General Electric Company for an exemption to the Employee Retirement Income Security (ERISA) Act per application number D-5701. In response to an inquiry, Mr. David Stander, Office of Regulations and Interpretations, Pension and Welfare Benefit Programs, US Department of Labor, sent me five sheets titled "General Electric Pension Plan Notes to Financial Statements".

General Electric management has repeatedly stated that the General Electric Pension Trust is an irrevocable trust. In the General Electric Newsnotes for Pensioners Spring 1985 one paragraph states that "The GE Pension Trust - founded in 1927 - was one of the first in the nation. It can be used only to pay GE pensions."

However, the "General Electric Pension Plan Notes to Financial Statements" sent to me by Mr. David Stander are shocking because on page 3, paragraph 8, Plan Termination is described. The top of page 3 states, "Although it has not expressed any intention to do so, General Electric Company has the right under the Plan to discontinue contributions at any time and to terminate the Plan subject to the provisions set forth in ERISA. The second paragraph of page 4 states," Whether all participants receive their benefits should the Plan terminate at some future time will depend on the sufficiency at that time, of the Plan's net assets to provide those benefits and may also depend on the level of benefits guaranteed by the PBGC."

The net asset value of the General Electric Pension Trust has been described in various publications and at various times as being between $9.7 billion and $12 billion. With 108,000 retirees and 230,000 current employees one must consider the tremendous impact that termination of the GE Pension Plan would have on 338,000 individuals. General Electric Company believes that it has the right to "terminate the Plan subject to the provisions set forth in ERISA" This statement by General Electric is sufficient reason for consideration of legislative improvements to ERISA which will restrict plan terminations and prevent wholesale terminations being approved by Dept. of Labor, Treasury(IRS), and the PBGC as has been done for the past four years.

SERIOUS VIOLATION OF EXISTING LAW

Senator Howard Metzenbaum has testified that in his opinion the wholesale termination of pension plans which is being permitted is a serious violation of existing law. Through these terminations, the Executive Branch of the Government is giving a semblance of legality to the very same actions which the ERISA law was intended to prevent. The law was intended for retirement income security not for dissipation or dissolution of the pension funds.

Since a more restrictive law is needed, the Congress should proceed to pass one before the pension plan termination virus is caught by more corporations to the detriment of the employees in the United States.

Sincerely,

Walter R. Nial

Mobil Oil Corporation

150 EAST 42ND STREET
NEW YORK, NEW YORK 10017-5666

REX D. ADAMS
VICE PRESIDENT
EMPLOYEE RELATIONS

July 23, 1985

The Honorable William Clay
Chairman
Labor-Management Relations Subcommittee
2451 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Edward R. Roybal
Chairman
Select Committee on Aging
712 Annex 1
300 New Jersey Ave., SE
Washington, D.C. 20515

Re: Termination of Superior Oil Company
Pension Plan by Mobil Oil Corporation

Dear Congressman Clay and Congressman Roybal:

On behalf of Mobil Oil Corporation, I am responding to statements made before your Committees on June 12, 1985, by Ms. Karen Friedman of the Pension Rights Center. Ms. Friedman's description of the acquisition of Superior Oil Company by Mobil and the termination of the Superior pension plan was inaccurate and misleading. I appreciate your giving Mobil this opportunity to set the record straight.

Before discussing the two specific points that are the subject of this statement, I want to note for the record that I am disheartened to read the adverse testimony regarding Mobil's treatment of Superior employees. Time and again as questions involving Superior employees arose, particularly questions about their benefits, they were resolved in favor of the Superior employees.

Let me turn now to the two points that are set forth in detail below. First, all former Superior employees received pension benefits equal to or better than the benefits provided under Superior's defined benefit plan. As the name implies, such a plan defines the benefit which an employee is promised. The company commits itself to pay those benefits. It does not commit for more. Thus, Superior employees had no right or claim to benefits beyond those spelled out in the Superior defined benefit plan.

Second, the termination of the Superior pension plan was the most appropriate course to follow under the circumstances. Having satisfied all the liabilities of the Superior pension plan and provided substantial benefit improvements for a number of employees, Mobil was left with a surplus of assets. Those surplus assets might have been transferred to the Mobil Retirement Plan, but funding levels in that plan are already very high. The addition of assets to the plan beyond amounts sufficient to fully fund the liabilities being assumed was, in our view, a pointless and wasteful exercise.

Accordingly, Mobil sought a reversion of the surplus in the Superior plan after its liabilities and obligations had been fully met. Let me add that, contrary to Ms. Friedman's suggestion, the asset reversion of $45 million (not $250 million as Ms. Friedman stated) did not influence or precipitate the Superior acquisition or the lay off of any Superior employees.

MOBIL MET AND EXCEEDED PENSION PROMISES MADE BY SUPERIOR

Former Superior employees -- both those who now work as Mobil employees and those who do not -- were not "shafted", as Ms. Friedman suggested. Of the 3,400 Superior employees, 2,000 were hired by Mobil; 600 voluntarily rejected job offers from Mobil, found other jobs, or elected to retire; and 800 (not 1,400 as stated by Ms. Friedman) were not hired by Mobil. As to each group of employees, Mobil fully honored the defined benefit pension promises made by Superior. In many instances, Mobil provided benefits above and beyond those promised by Superior and expected by Superior employees.

Superior Employees Hired by Mobil

Former Superior employees now on Mobil's payroll were given an extremely generous package of benefits far exceeding those offered under their former plan.

> --They received "stay" bonuses for remaining in service after the merger equal to two weeks pay for each month worked up to 12 weeks pay for salaried employees.
>
> --They received guaranteed annuity contracts for vested pension benefits they had accrued under the Superior plan.
>
> --They were enrolled in Mobil's pension plan with full credit for ALL years of service recognized in the Superior plan. The Superior plan had a liberal provision recognizing some years of service in the oil industry prior to actually joining Superior. When Superior employees joined Mobil, then, all their Superior years and their recognized previous oil industry years were credited. There was no waiting period, no break-in service, and no loss of years in calculating the pension.

--They continue to be eligible for liberal early retirement under the provisions of the Superior plan (eligible at age 55 with 5 years of service) even though Mobil's early retirement policy is tighter (eligible at age 55 with 15 years of service).

--They will receive at retirement a pension benefit calculated under the more generous one of two formulas -- either under the Mobil formula (total credited years of service times 1.6% of final average pay) or under the Mobil/Superior formula (the Mobil benefit for service after the merger plus the accrued Superior benefit, which is calculated using years of service times 1.5% of final average pay).

--They are eligible to take their pension benefits in forms promised under the Superior plan, although those forms are not provided under the Mobil plan.

--They were covered by Mobil's welfare plans which are as good as or better than Superior welfare plans.

Superior Employees Not Hired by Mobil

About 1,400 former Superior employees did not come to work for Mobil. Six hundred of these either found other jobs or elected to retire. Eight hundred were laid off (not 1,400 as Ms. Friedman suggested).

With regard to all these employees, Mobil fully met the pension and other benefit promises Superior had made. Those who retired received the retirement benefits they had earned under the formula in the Superior plan. All other former Superior employees who had worked at least one year for Superior were immediately vested in the Superior pension plan and received guaranteed annuity contracts. Without regard to whether they had met the regular vesting requirement, all former Superior employees with one year of service who left voluntarily to take other jobs or who were terminated became vested terminated. They will receive pension benefits in the forms that Superior had promised even if they were short-service employees.

In addition to paying or guaranteeing these pension benefits under the Superior pension plan, Mobil extended to all former Superior employees the "stay" bonus described above. Former Superior employees who were terminated received both a three-month paid notice period during which employees had no job responsibilities and a special termination allowance of at least two weeks base pay per year for each credited year of service. Mobil established an out-placement center to assist them in finding jobs. Data show that almost 95 percent of those laid off are now employed.

Friedman Example Is Inaccurate

Ms. Friedman described a 61-year-old former Superior employee "hurt" by the merger of Mobil and Superior, because her benefits were "frozen." This woman received the benefits she had accrued under the Superior plan, according to her years of service and her pay. All plans have age, years of service, and other provisions which an employee can make or miss. She also received the array of generous termination arrangements -- the stay bonus, the termination allowance, the three-month paid notice period, et al.

The Superior plan did not promise that she could continue to work until a specified future date in order to accrue additional benefits or that she could get any benefit increases after retirement benefits started. Neither Mobil nor any other business enterprise offers employees permanent employment. When confronted by business conditions, such as those now faced in the petroleum industry, that lead to painful but necessary terminations, companies can honor obligations to employees in a fair and generous manner. Mobil did just that.

PLAN TERMINATION AND REVERSION OF ASSETS APPROPRIATE

Ms. Friedman suggested that there was some sinister linkage between the acquisition of Superior, the job lay offs, and the termination of the Superior pension plan. Nothing could be further from the truth. The decision to terminate the Superior plan was made independently of the other decisions and, more important, was the appropriate decision in the interest of all Superior's employees.

The decision to acquire Superior was not fueled in any way by consideration of the assets in the Superior pension plan. Indeed, it seems ridiculous to attempt to make that link. The acquisition cost Mobil $5.7 billion. The excess pension plan assets of $45 million, although a considerable sum in its own right, pales by comparison. Furthermore, the cost to Mobil of special stay bonuses, termination allowances, personnel costs, and the like was a far greater sum.

The decision to lay off employees was the result of reevaluating and restructuring workforce needs and was not influenced by pension plan obligations. It is entirely possible, given the state of the oil industry, that Superior itself would have made layoff decisions on a similar scale, contrary to what Ms. Friedman suggested. Job termination decisions are always difficult, whether prompted by general economic factors or by a merger. Once such decisions are made, however, terminated employees are entitled to the benefits promised to them by their former employer. As already stated, Mobil met and exceeded the promises made by Superior.

The termination of the Superior pension plan was done for reasons which have nothing to do with the acquisition or lay off decisions. It was economically inefficient and not in the interest of Superior's employees to administer both the Mobil plan and the Superior plan after the merger. Let me stress again that the termination will have no adverse effect on any Superior employee. More than 2,000 ex-Superior employees will realize better pension benefits after the merger than they could have gotten under the Superior plan. After paying about $87 million for annuities guaranteeing the payment of pension benefits to Superior employees practically all of whom had vested rights in the Superior plan, the Superior plan had $45 million left in assets. In other words, the plan had much more than it needed to satisfy the defined benefit promises and liabilities that had accrued to date. Benefits accrued after the merger fall under the Mobil plan.

Once the liabilities under the Superior plan were met, the assets left in the plan were appropriately put to use by Mobil. Rather than allowing that money to sit in a plan to which no one had a claim or transferring the assets to Mobil's plan which is already fully funded, Mobil sought and obtained a reversion of the assets. The reversion represented sound business judgment and was done in conformance with all legal requirements after Mobil had taken all steps to assure that the participants would be fully protected.

CONCLUSION

Mobil shares the concern that many have expressed over the potential for abuse when pension plans are terminated and assets are recaptured. The Mobil/Superior situation, however, is not illustrative of any abuse or unethical practice. In addressing situations where abuse may occur, we hope that your Committees will be mindful of cases such as this. The reversion of pension plan assets can be a solid business decision with no adverse impact.

Sincerely,

Rex D Adams

Rex D. Adams
Vice President-Employee Relations

cc: Members, Labor-Management Relations Subcommittee
Members, Select Committee on Aging
Phyllis Borzi, Esq.
Roger Thomas, Esq.

SUPERIOR OIL

June 11, 1985

Representative Edward R. Roybal
Attn: Roger Thomas
House Select Committee on Aging
Room 711, House Annex One
300 New Jersey Ave., S.E.
Washington, D. C. 20515

Dear Rep. Roybal:

The company I worked for the last seventeen years, The Superior Oil Company, was acquired by Mobil Oil Corp. in September, 1984. Superior's top management left the Company beginning December 1, 1984. The exodus continued at a rapid rate and by February 1, 1985 all of top management and most of the managers at Superior had gone elsewhere leaving the rank and file employees completely vulnerable. Mobil named H. K. Holland, Jr., a Mobil employee, as Chairman of Superior's Board of Directors and he in turn named the members of the Benefits Committee, all Mobil employees. This Committee is responsible for the administration of the Superior Retirement and other benefits plans.

Mobil immediately began the necessary steps to terminate the Superior Retirement Plans effective 12-31-84. Holland notified the participants of the plan termination in a letter dated January 18, 1985; however, the letters were not mailed until after February 1, 1985. Since Mobil had not given prior notice of intent to terminate, they did grant all participants two months' additional accrual in the Plan - January and February, 1985. If employees at Superior continued on the payroll after February, 1985, 8.5% of base salary was added to their pay as compensation for the loss of retirement accrual. Mobil hoped to recover approximately $29 million from the Superior plans in excess assets; however, it now appears that their expectations were high. The bottom line will be between $4 and $5 million.

The above background was provided so that you might understand the sequence of events in this particular plan termination.

I feel it is very unfortunate that acquiring companies are allowed to terminate retirement plans and recover the excess assets then pump those funds back into their treasury to help eliminate the debt incurred by the acquisition.

Retirement plan terminations and the recovery of plan assets should be discouraged at all costs, especially in situations described above.

The Superior Oil Company P.O. Box 1521 Houston, TX 77251 (713)751-4111

Technically this is not a "recovery" but may I suggest instead a "Windfall Profit" and as such should be taxed accordingly. Mobil Oil did not contribute to the well being of Superior or its active and retired employees, nor have they made cash payments to the plans. Therefore, I feel "recovery" in this situation is erroneous terminology.

The purpose of Superior's Retirement Plans, as stated in plan documents is, "to provide retirement and incidental benefits to those Members who complete the required period of employment with the Company. The benefits provided by the Plan will be paid from the Trust Fund and will be in addition to any benefits the Members may be entitled to receive pursuant to any other Company programs or pursuant to the federal Social Security Act. The Plan and the Trust are established and shall be maintained for the exclusive benefit of the MEMBERS and their beneficiaries. No part of the Trust Fund can ever revert to the Company, except as hereinafter provided, or be used for or diverted to purposes rather than the exclusive benefit of the Members and their beneficiaries". This then is rhetoric and has no meaning if Mobil and other corporations are allowed to use these assets for their purposes.

Pension plan assets should be used for pensions and enhancements of benefits if sufficient assets are available. I am aware that some experts contend that "no employee is being denied their rightful retirement benefit because of plan terminations. In fact," they say, "many employees are reaping benefits they're not entitled to, since all employees, whether or not they're fully vested, are automatically considered fully vested at termination." What these "experts" seem to overlook is the older long term employee does indeed sufrer irrevocable loss of benefits. As an example; one of our employees continued to work past February and retired on July 1, 1985. Her lifetime monthly annuity is $1,085. Had this annuity been calculated using five instead of two months' accrual for 1985 and other plan provisions if the plan had not been terminated on 12-31-84, her monthly annuity would have been $1,182 for the remainder of her life, or a difference of $37 a month. Using her life expectancy of 22.9237 from the GA 75 Complete Expectation Life Table used by the Plan, she has forfeited a total of $10,178. The 8.5% of base salary for the additional three months only totals $809.64. This is only one example of tangible and future loss for one female individual, age sixty-one. There are sixty-three more Superior employees who retired after March 1, 1985 in similiar situations. There is not much consolation to this group to know that short term employees received benefits not normally due them, when these long service employees have forfeited so much!

It is also my opinion that plan administrators are neglecting their fiduciary duties as defined by ERISA, which states that pension assets must be used for the "exclusive benefit" of plan participants. Futhermore, when surplus funds are used by acquiring Companies to help reduce the debt incurred by that acquisition, it becomes a bitter pill for the nearly 1,400 employees here at Superior who lost their jobs. Although nearly 1,900 Superior employees were retained by Mobil, they do not have the same jobs with the same level of authority, nor in many instances in the same geographic location necessitating relocation of entire families and the trauma that produces.

Acquisitions will continue and larger corporations will continue to eat up medium and small corporations as long as it remains profitable for them to do so. The looser in all of this ultimately is the consumer, you and I. Mobil purchased Superior for its reserves and reserves only. It was cheaper for them than exploring for oil because of their management's philosophy. When more reserves are needed, they will again purchase another company and the cycle begins again with another acquisition paid for by the employees of that acquired company as it has in the past with the purchase of General Crude. This may be legal, but morally I feel it is wrong. In this industry, consumers will pay more for gasoline than would have been necessary had smaller companies remained independent and allowed to discover and produce oil and gas. Therefore, not only are these employees financing the take-overs through their pension plans, but also in higher prices at the gas pump, in addition to the loss of job security and future earnings. This is a pretty big price to pay. The only recourse ex-employees of Getty, Superior and Gulf Oil have is legal action. Large corporations like Mobil and Texaco will spend whatever is necessary to retain control of these pension funds. These corporations had no hand in funding or providing the work environment that produced the monies necessary to fund these plans in the past. Therefore, we all remain in a no win situation, ex-employees, retirees, plan participants and consumers alike.

I hope the above information will be of help to you and your committee. Should you wish additional information, you may contact me at Superior through June 30, 1985 at (713) 756-4379. After that date you may contact me at the following address:

289 Hereford Drive
Conroe, Texas 77304
(409) 756-2264

Very truly yours,

Vi McAllister
Sr. Benefits Administrator

vm

STATEMENT OF JOHN N. ERLENBORN, PARTNER, SEYFARTH, SHAW, FAIRWEATHER & GERALDSON, WASHINGTON, D.C.

Mr. Chairman, thank you for allowing me to present this statement concerning the overfunding of defined benefit pension plans and the disposition of excess assets. I ask that my statement on this timely and thought-provoking subject be considered in the context of my experience as a former member of the Labor-Management Relations Subcommittee, the former ranking minority member of the full Education and Labor Committee, and one of the architects of ERISA, rather than as a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson.

First, let me admit my bias towards defined benefit pension plans as an ideal vehicle to provide the retired worker with a guarantee of a stream of income in post-working years. Though defined benefit plans are not the only means to provide retirement income security, they do, in combination with Social Security benefits, meet the needs of the majority of workers.

For a variety of reasons, including the funding standards enacted in ERISA and recent stock market advances, many plans have experienced a growth in assets beyond that needed to fund for accrued benefits. In addition, historically high interest rates have reduced the cost of annuities that might be purchased to provide benefits. The result, in the past few years, has been an increase in the termination of defined benefit plans and the reversion of excess assets to the plan sponsor. In some instances, takeovers of corporations have been prompted, at least in part, by the knowledge of the existence of excess funds in the corporation's pension fund.

To a great extent, the debate that has taken place over recapture by the plan sponsor of these excess assets has been centered on the proper distribution of the funds. Should they belong to the plan participants or go to the plan sponsor or some division between them? Even Uncle Sam has gotten into the act with a suggestion that some part should go to the U.S. Treasury in the form of an excise tax.

In my opinion, the debate has been centered on the wrong issue. In arguing whether excess assets should be allocated to benefit increases, returned to the plan sponsor or some other disposition, the participants in the debate seem to accept that the plan will be terminated. It is the fact that the law now requires the termination of a plan to allow the plan sponosr access to the excess funds that is the heart of the problem.

What I suggest is not novel and at least one witness, Don Grubbs of Buck Consultants, Inc., recommended this approach in testimony at the joint hearing held June 12, 1985. This solution would be to permit the plan sponsor to withdraw the excess assets but still continue the plan. There is no need for me here to restate the Grubbs' solution, but it includes safeguards so that all accrued benefits will remain funded and an additional amount would remain in the fund to guard against future adverse experience.

I cannot improve on the conclusion contained in Don Grubbs' statement of June 12 but only repeat it and adopt it as my own:

> The fundamental problem is that employees are losing pensions. The cause is that current law gives employers an incentive to terminate defined benefit plans in order to obtain the plan's excess assets. The solution is to allow employers to withdraw the excess assets without terminating the plan, while maintaining controls to protect the funding of all accrued benefits. This approach can be combined with the disincentives to termination of an excise tax.

APPENDIX III

David L. Rossi
203 West Monroe Avenue
New Castle, De. 19720

JUN 25

June 23, 1985

Congressman William L. Clay
Chairman, Subcommittee on Labor-Management Relations
House Annex I
300 New Jersey Avenue, S.E.
Washington, D.C. 20515

Dear Congressman Clay:

I would like to share my views with you concerning the subject of termination of defined benefit pension plans, which your subcommittee addressed in hearings held on June 12, 1985.

I am greatly concerned about the long-term economic impact of current unrestricted pension plan terminations and asset reversions engineered by top level corporate managers.

Pension plans were established to provide employees with a source of income after retirement, and serve as an incentive to attract and retain qualified people. Employer contributions to a pension plan on behalf of employees represent deferred wages set aside for future periods and are not temporary investments of corporate funds intended to yield investment income to the employer. Pension contributions are part of the total compensation earned by employees each day.

Pension plans were established for the benefit of retirees and their beneficiaries. However, these plans have been managed in recent years as though they were primarily established to benefit the employer.

Private pension plans are assuming ever greater importance when one considers the ever-increasing uncertainties of the Social Security System. If we permit private employers to systematically dismantle the private pension system, then we are going to be in big trouble. When one also considers the current trend in American industry toward wage and salary cuts, as well as the implementation of two-tiered wage structures, prospects for the future are made even worse. Given declining incomes and ever-increasing costs of living, the average working family will be unable to take advantage of the savings incentives already provided by the Internal Revenue Code which permit the deferral of taxes on up to 15 per cent of one's compensation, as well as tax deferral through investments in Individual Retirement Accounts.

It is important for us to realize that the relationship between corporations and pension funds is a two-way street. Not only do corporations make sizable investments in pension plans, pension plans also make sizable investments in corporations. State and local government pension funds, along with corporate pension plans control a staggering $1.3 trillion of stock in U.S. corporations, up from $400 million a decade ago.[1] Pension plan assets make up about seven per cent of total U.S. assets.[2]

The Employee Benefit Research Institute, a non-profit study group based in Washington, reports that pension plans cover 37 million workers in the United States. According to the Institute's figures, there were 560,719 defined contribution plans and 377,628 defined benefit plans in 1983. The recent trend in pension establishments favors the defined contribution plan over the defined benefit plan. According to the Employee Benefit Research Institute, between the years 1974 and 1983 defined contribution plans increased by 192 percent, while the number of defined benefit plans rose 63 percent.[3]

The healthy growth of pension plan assets in recent years has helped considerably in the revitalization of our economy. This pension growth is also responsible for the accumulation of large excess assets in defined benefit plans. This excess is estimated to be anywhere between $70 billion and $150 billion. According to Johnson and Higgins, a Wall Street consultant specializing in employee benefits, 329 of the nation's biggest corporations have $42 billion more in their pension funds than they need to pay the benefits which employees have earned.[4] However, recent statistics on pension terminations show that nearly 700 pension plans have been cashed in, netting a recovery of excess assets of approximately $7.5 billion. If this trend in pension terminations continues unabated over the next five to ten years, excess pension assets will be entirely depleted, especially if we see an extended downturn in the economy resulting in poor plan performance. When these vast excess assets dry up, so too will the opportunity for plan participants to receive cost of living adjustments and improved benefit formulas.

Corporate managements advance many reasons to justify their termination of company pension plans. Among the reasons given are that the plans are too expensive to maintain, that the excess funds could be better invested in capital expansion or in subsidizing operating expenses, that they are needed to finance corporate acquisitions or to fend off a hostile takeover attempt.

As far as I'm concerned, none of these reasons is compelling. In 1983, according to Johnson and Higgins, employee pensions cost Fortune 500 companies and the 200 largest service companies in the United States an average of $1,388 per employee.[5] Surely this is not too great a cost for these companies to handle.

In 1984, there were 2,543 announced mergers, the highest number in ten years. These mergers, which included the divestiture of company divisions and leveraged buyouts, required a record $122.2 billion to finance.[6] Of this amount, nearly $30 billion was used to finance oil company mergers alone. This $122.2 billion was spent not for the purpose of finding and developing new resources but merely for the purpose of transferring ownership of already existing resources. And then we wonder why we have difficulty competing with foreign producers.

Pension plans have been adversely affected by the tendency of employers to use excess plan assets to fight off hostile takeovers. The payment of greenmail to corporate raiders has cost dearly. Pension funds have lost millions of dollars on their investments as stock prices fell in corporations that paid huge ransoms to fend off corporate takeover artists, such as Carl Icahn and T. Boone Pickens.[7]

As far as using excess pension assets to finance corporate acquisitions is concerned, Texaco provides a good illustration. Texaco, in January 1984, spent $10.13 billion to purchase the Getty Oil Company. In so doing, it increased its long-term debt fivefold. This takeover decision also increased the percentage of its debt to total assets from 45.9% before the merger to 63.6% after the merger, with a corresponding decline in its equity. However, the decision to acquire was made with full knowledge of the financial consequences. It should not be expected that the participants in the Getty pension plan shoulder a portion of the acquisition cost.

Section 403(c)(1) of ERISA states that except as provided under Section 4044 of the statute, "the assets of a plan shall never inure to the benefit of any employer, "but rather shall be held to exclusively provide benefits to plan participants and their beneficiaries, and to defray reasonable expenses of administering the plan.[8]

Before ERISA was enacted, IRS regulations prohibited a transaction that was followed by the establishment of a comparable defined benefit plan. After ERISA was enacted, both the IRS and the Pension Benefit Guaranty Corporation prohibited such an establishment, maintaining that the net effect of terminating one defined benefit plan and replacing it with another comparable defined benefit plan would be that the employer had recovered assets from an on-going plan, a violation of the Internal Revenue Code.[9]

The spinoff termination method likewise was considered to be illegal. In the early 1980's the PBGC informed plan sponsors who submitted spinoff notices that it was unable to conclude that the spinoff transaction constituted a plan termination recognizable under Title IV of ERISA and, accordingly, could not issue a sufficiency notice to the company.[10]

Edwin M. Jones, former executive director of the PBGC, sought to outlaw spinoff terminations and termination-reestablishments, contending that both of these actions were shams. He convinced the IRS of this and the tax agency declared that both techniques constituted tax abuse.[11]

Unfortunately for the average pension plan participant, the IRS and the PBGC have reversed their positions on the legality of these two termination methods and now routinely give rubber-stamp approval to any termination request which corporate America puts before them.Not only that, agency personnel now conduct seminars for corporate managers detailing the procedures to be followed in concluding a termination. In my view this is totally irresponsible.

The May, 1984 guidelines jointly implemented by the PBGC, the Department of Labor and the Treasury Department now permit termination procedures that earlier were not regarded as valid.[12] This change in government policy has been accomplished not through amendments to existing law, but through administrative manipulation carried out by carefully selected political appointees.

It is also interesting to note that while ERISA has prescribed certain fiduciary standards in the administration of pension plans, in practice these standards apparently apply to no one in particular, as it seems that everyone is exempt from these standards.

One cannot overemphasize the seriousness of the present situation. Indeed some action is necessary by the Congress to stem this abuse. Nearly one million plan participants have been affected already. The number could eventually become much larger unless something is done now. It is interesting to note that many overfunded plans are only slightly overfunded when considered on an ongoing basis. It is only when considered on a termination basis that the excess appears so large.

In conclusion, I would like to urge the Congress to enact legislation that will effectively prohibit the pension plan termination abuses which have become so prevalent today. I am confident that the Congress will properly address this issue.

I respectfully request that this letter be made part of the hearing record.

Sincerely,
David L. Rossi
DAVID L. ROSSI,
Certified Public Accountant

FOOTNOTES

1. Fighting America's New Buccaneers . Neil R. Peirce. Wilmington News Journal, June 2, 1985.
2. Companies Take Stock in Pensions. Merritt Wallick. Wilmington News Journal, December 9, 1984.
3. Pension Planning Comes of Age. Merritt Wallick. Wilmington News Journal, December 9, 1984.
4. Pension Planning Comes of Age. Merritt Wallick. Wilmington News Journal, December 9, 1984.
5. Pension Planning Comes of Age. Merritt Wallick. Wilmington News Journal, December 9, 1984.
6. Takeover Fever Hits New Heights. Dan Dorfman. Wilmington News Journal, April 7, 1985.
7. Fighting America's New Buccaneers. Neil R. Peirce. Wilmington News Journal, June 2, 1985.
8. Reversion of Defined Benefit Pension Plan Assets to the Employer: Policy, Practice and Implications. Carmen D. Solomon. Congressional Research Service, October 18, 1984.
9. Reversion of Defined Benefit Pension Plan Assets to the Employer: Policy, Practice and Implications. Carmen D. Solomon. Congressional Research Service, October 18, 1984.
10. Reversion of Defined Benefit Pension Plan Assets to the Employer: Policy, Practice and Implications. Carmen D. Solomon. Congressional Research Service, October 18, 1984.
11. Hands in the Cookie Jar. Thomas G. Donlan. Barron's, May 21, 1984.
12. Reversion of Defined Benefit Pension Plan Assets to the Employer: Policy, Practice and Implications. Carmen D. Solomon. Congressional Research Service, October 18, 1984.

GETTY OIL RETIREES' CLUB
52-46 Concord Avenue
Little Neck, New York 11362

Jul 11

July 9, 1985

Congressman Edward R. Roybal, Chairman
Select Committee on Aging
U. S. House of Representatives
300 New Jersey Avenue, S.E. Room 712
Washington, D. C. 20515

Dear Mr. Chairman:

This letter is written to you in behalf of members of the Getty Oil Retirees' Club embracing approximately 150 members residing in the Metropolitan New York area, the States of New York, New Jersey, Pennsylvania, Connecticut, Massachusetts, Rhode Island, Maine, Maryland and Florida.

Reference is made to the Joint Hearing on Overfunded Pension Plan Terminations held on June 12, 1985 by the House Select Committee on Aging of which committee you are Chairman.

You will recall that Mr. Arthur R. Wilson, President of Local 8-898 of the OCAW appeared at that hearing as a witness representing active employes of the former Getty Oil Company ("Getty") Delaware Refinery. Following the hearing, Mr. Leroy V. Scott, a retiree of Getty and now Chairman of the Getty Delaware Refinery Retirement Group wrote to you on June 19, 1985 requesting that the comments set forth in his letter be added to the Joint Hearing records.

Members of our Club have requested us to write you and express their concurrence and agreement with Mr. Wilson's presentation at the hearing as well as to the contents of Mr. Scott's letter to you dated June 19th.

Members of our Club were not aware of the guidelines adopted for "spin-offs/terminations" of pension plans until receipt of a letter dated December 14, 1984 from Mr. John C. Grant, Management Employe Benefit Plans Committee of Texaco Inc. advising of Texaco's determination to spin-off certain assets to Texaco and for the subsequent termination of the Getty Pension Plan.

Our group feels that had it been given the opportunity prior to adoption of the guidelines, we would have, at that time, voiced our opinion as to the unfairness of the proposed guidelines. Notice should have been given all participants of pension plans of the proposed changes. As citizens and as persons having a vested interest in such pension plans our rights to express our opinions were denied us.

The group has asked us to write to you and convey our thanks and appreciation for your efforts to endeavor to stop this piracy of pension funds. When we retired from Getty we felt assured of continuance of pensions for our life time and that of our contingent beneficiaries. Now apprehension dominates among the group.

Congressman Edward R. Roybal, Chairman July 9, 1985
Select Committee on Aging

We beseech and implore you and your committee to continue and hasten your efforts to amend the guidelines before any approval is granted to the proposed Texaco "spin-off/termination" of the Getty Pension Plan.

Yours very truly,

GETTY OIL RETIREES' CLUB

J.C. Murphy
J. C. Murphy, Chairman

Wilbur Loew
Wilbur Loew, Secretary

OCAW

Oil, Chemical & Atomic Workers
International Union, AFL-CIO

Delaware City Local 8-898
5 Peddlers Village
Christiana, Delaware 19702
302/737-8898

June 14, 1985

Congressman William L. Clay
Chairman, Subcommittee on Labor-Management
House Annex I
300 New Jersey Avenue, S.E.
Washington, D.C. 20515

Dear Congressman Clay:

During the Hearing on Pension Plan Reversions of June 12, 1985, remarks by Congressmen Matthew Rinaldo and James Saxton seemed to imply that a possible solution to the problem could be addressed through collective bargaining. Time constraints at the Hearing prevented me from personally responding to the erroneous assumption on a most important and pertinent issue.

Collective Bargaining for retirees is not a mandatory subject of bargaining under the Taft-Hartley Act according to National Labor Relations Board rulings. An employee has no specific injury until actually on retirement. Unions under the law, however, can only represent those employees actively on the payroll.

Getty has historically refused to bargain on subjects pertaining to retirees. (ie: COLAs, medical coverage, etc,.) despite intense effort by the Union on numerous occasions to enter into negotiations on such matters.

I must again emphasize that the only avenue of relief available to the working men and women, organized or unorganized, is some form of direct regulation by Congressional action.

I respectfully request that this letter be made part of the Hearing Record.

Sincerely,

ARWilson

Arthur R. Wilson
President

fw

Delaware Getty Retirement Group

2307 Milltown Road,
Wilmington, De. 19808

JUN 24

June 19th, 1985

Congressman Edward R. Roybal, Chairman
Select Committee on Aging
U. S. House of Representatives
300 New Jersey Avenue, S.E. Room 712
Washington, D.C. 20515

Dear Mr. Chairman:

My name is Leroy V. Scott, a retiree of the Getty Oil Company since 1973, and currently the Chairman of the Delaware Getty Retirement Group, a group composed of over 250 Getty retirees.

We are very sorry that due to the limited time available to you at the Joint Oversight Hearing on overfunded pension plans held on June 12th, we did not have an opportunity to express the particular concerns of our Group of retirees to the "spin-off/terminations" of overfunded pension plans, an action in which we are currently the victims. Mr. Arthur R. Wilson, President of Local 8-898 of the OCAW representing the active employees of the former Getty Delaware Refinery did appear as a witness. We are in full agreement with his presentation and we wish to add the following comments for your record.

The sale of Getty Oil to Texaco, Inc. in 1984, and the filing for a "spin-off/termination" of the Getty Pension Plan in December, 1984, is no doubt well known to the members of both the Sub-Committee on Labor-Management Relations and the Select Committee on Aging. We can only state that our Group, as well as all other Getty Retirees, is totally opposed to this action which will result in Texaco, Inc. capturing the overfunded assets of our pension plan of some $250 million which they will use to retire some of the debt incurred in purchasing Getty Oil. We trust the Joint Committee will find justification in acting to amend the 1974 ERISA which permits such actions, and if possible, issue an injunction to hold in abeyance those actions now pending.

Our Group is deeply troubled over the fact that they are to be issued insurance annuities which will adversely affect the security of all retirees. This action will preclude future pension supplements which in the past has assisted retirees in coping with inflation; supplements which have been paid out of the Pension Fund.

More importantly, it is our understanding, according to a Los Angeles Times article on pension raids, dated May 12th, 1985, that the Pension Benefit Guaranty Corporation, the federal agency set up under ERISA, will not insure retirement benefits once they are no longer paid out of a defined pension plan and are paid by an insurance carrier.

We see no logical reason why they cannot be continued to be guaranteed by this agency by simply having the insurance carrier continue the necessary contributions to the PBGC for those so affected. The original intent of ERISA was to guarantee pension benefits, yet current regulations contradict these guarantees. We believe they should be corrected immediately and the promised protection be restored.

A further point of general concern stems from the fact that the Getty Pension Plan was a contributory plan from 1950 to 1970, and most of our current retirees contributed a percentage of their salary and/or wages into the Pension Fund during all of that period. Efforts to have Texaco return contributions made, plus interest, out of the excess assets have to date been in vain.

We believe a return of our contributions, plus interest, out of the excess assets, to be patently fair and equitable, as employee contributions helped generate the excess assets in the Fund over the years through very favorable investment results. We believe we are further supported in this matter by PBGC regulations which provides specifically for reversion to employers of only those residual assets that are not attributable to employee contributions. We also understand that in a letter to Chairman Roybal from Mr. E. M. Jones, Executive Director of PBGC, he clarified the reference to distribution to plan participants of their contributions following other priority distributions. Evidenc[illegible] this matter requires further attention so that a fair and equitable distribution of excess assets is made if overfunded pension plan terminations continue to be approved.

Finally, it is most difficult for all of our retirees to understand the fairness in legislation that permits a company like Texaco to acquire the employees' pension fund, terminate it and walk off with all of the excess assets. It has always been our understanding that Pension Plan Trustees were obligated to use Trust Funds solely for the benefit of participants and that the Fund was not considered as part of a company's assets to be sold or transferred.

In closing, we believe ERISA of 1974 is being grossly abused by corporate mergers where termination of pension plans with excess assets will result in reducing their purchase price. We earnestly hope the Joint Committee will endeavor to amend the Act to stop overfunded reversions to employers and protect the rights of all pension plan participants.

Respectfully submitted,

Leroy V. Scott, Chairman
Delaware Getty Retirement Group

s/

SOS
COALITION TO PROTECT
SOCIAL SECURITY
S.O.S. SAVE OUR SECURITY S.O.S.
1201 16th ST., N.W., SUITE 222, WASHINGTON, D.C. 20036
TELEPHONE: (AREA CODE 202) 822-7848

(4)

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Former Advisor, American
Association of Social Security

Legal Counsel
ELLIOT BREDHOFF, Esq.
Bredhoff & Kaiser

Staff Consultant
KEITH TARR-WHELAN

June 18, 1985

Hon. Edward R. Roybal, Chairman
House Select Committee on Aging
2211 Rayburn House Office Bldg.
Washington, DC 20515

JUN 2

Dear Chairman Roybal:

The Save Our Security coalition, representing over one hundred national organizations, wishes to place on record its general support of H.R. 2701, the Plan Termination and Revision Act of 1985.

We commend your initiative in an area which only now is getting the press and public attention it deserves.

For years we pressed for legislation to correct underfunding of pension plans. The 1974 ERISA legislation fulfilled that effort. Now we face a different problem -- companies terminating overfunded defined benefit plans. The recent United Airlines case has dramatized the problem.

This coalition commends to you the statement made to you by the AFL-CIO on June 12 and fully supports that statement.

With the minor amendments suggested by the AFL-CIO to H.R. 2701, we urge Congress to pass this legislation and pledge to assist you and your committee in whatever way we can to bring that about.

Sincerely,

Keith Tarr-Whelan

Keith Tarr-Whelan
Staff Director

KT-W/as

A national advocacy coalition concerned with all aspects of Old Age, Survivor's and Disability Insurance,
Medicare, Medicaid and Supplemental Security Income

5

National Council of Senior Citizens
925 15th Street, N.W. • Washington, DC 20005 • Phone (Area Code 202) 347-8800

Presidents Emeriti
James Carbray
Whittier CA

Nelson H. Cruikshank
Washington DC

President
Jacob Clayman
Washington DC

Executive Director
William R. Hutton
Washington DC

July 3, 1985

The Honorable Edward R. Roybal, Chairman
House Select Committee on Aging
U.S. House of Representatives
2211 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roybal:

The National Council of Senior Citizens, representing over 4.5 million older Americans across the country, strongly supports H.R. 2701, the Plan Termination and Control Act of 1985. This bill would effectively deal with the abuses that are occurring with increasing regularity in the area of pension plan termination and the reversion of "excess" pension assets.

In passing the Employees Retirement Income Security Act (ERISA), lawmakers, industry representatives, trade unions and senior citizen representatives worked together to create a system that would provide long-range retirement security for generations of retirees. Accordingly, ERISA requires that those responsible for administering pension plans must act prudently and for the exclusive benefit of their participants and beneficiaries. Today, the intent of ERISA and, indeed, the retirement security of thousands of Americans may be in jeopardy as a result of corporate misuse of pension funds through pension plan terminations and the reversion of excess pension assets.

The growing trend among companies to terminate so-called "overfunded" pension plans in order to recapture——for the companies' exclusive benefit——what they term "surplus assets" is indefensible and must be brought to a halt. Reversions strip workers of expected benefits, prevent retirees from obtaining needed cost-of-living adjustments and mock the integrity and promise of the nation's private pension system.

We commend you for your efforts to halt reversions and for recognizing that any "surplus" assets that now exist in pension funds rightfully belong to workers and retirees. NCSC urges you to move quickly toward passage of H.R. 2701 or similar legislation that will effectively prevent employers from diverting pension fund assets to corporate purposes and jeoparding the income security of millions of retirees.

Sincerely,
William R. Hutton
William R. Hutton
Executive Director

WRH/D/hd13

First Vice President, Dr. Mary C. Mulvey, Providence, Rhode Island • **Second Vice President,** George J. Kourpias, Washington, D.C.
Third Vice President, Einar O. Mohn, Menlo Park, California • **Fourth Vice President,** Dorothy Walker, Detroit, Michigan
Secretary-Treasurer, J. Al Rightley, Rochester, Michigan • **General Counsel,** Robert J. Mozer, New York

June 30, 1985

Administrator of Pension and Welfare Benefit Programs
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20216

ATTN: 3001 Comment Request

Gentlemen:

In my opinion, the termination of the United Air Lines pension plan for its' employees is illegal according to the Internal Revenue Code.

I worked as a United Air Lines flight attendant for thirteen years. If United contributed to the pension plan in good faith, as I did through my good work, any excess money in the pension plan should be used to increase benefits for retired employees -- not to enrich stockholders and corporate management.

Please deny United's request to terminate this pension plan unless they increase benefits for present and future retirees.

Workers' rights must be protected by the Federal Government.

The second plan is the United Air Lines, Inc. Flight Attendant Retired and Vested Terminated Employees' Plan (Plan Number 016). The company name is United Air Lines, Inc. The employee identification number (EIN) is 36-2675206. A committee appointed by the company is the plan administrator under the two plans. The Department of Labor must have the lesser of 10 employees or 10% of the employees who qualify as interested parties before the Labor Department can comment.

Sincerely,

Mary Kay Eldridge

Mary Kay Eldridge
6520 Fairlawn Drive
McLean, Virginia 22101
734-8270

P.S. What happens now. How can we stop this outrageous action?

6339 North 48th Place
Paradise Valley, Arizona 85253

June 6, 1985

Congressman Edward R. Roybal, Chairman
House Select Committee On Aging
United States House of Representatives
Washington, D.C. 20515

Re: Plan Asset Reversions - Plan Termination and Reversion Control Act of 1985

Dear Congressman Roybal:

As counsel for numerous pension plans and individual plan participants throughout the West - including California, and from the perspective of my own experiences as a plan participant, I wish to express my strong disagreement with the proposed Plan Termination and Reversion Control Act of 1985.

I have worked with and advised employees and employers in the area of qualified pension and profit sharing plans for over 10 years. During that period I have had an opportunity to observe first-hand the operations of thousands of pension and profit sharing plans, most of which have been sponsored by small and medium size business organizations. As a result of this experience, I am convinced that the proposed legislation would cause substantial harm to defined benefit pension plans covering tens of thousands of employees.

In proposing stricter controls on "over funded" plan terminations, it would appear that your Committee may have overlooked two critical factors. First, the nature of a defined benefit pension plan is such that an employer is necessarily at risk to fund the level of benefits specified by the plan. Second, Section 412 of the Internal Revenue Code imposes severe sanctions on employers who, in fact, fail to fund plan benefits.

An employer which is required to meet stringent funding guidelines but which - as proposed by your new legislation - would become ineligible to recover surplus assets from a plan - would be placed in an unfair and untenable position. I submit that many such employers will be encouraged to terminate their defined benefit pension plans altogether. As a matter of fairness and equity to an employer, as well as a matter of tradition, an employer which is "at risk" to meet the minimum funding standard pertaining to a plan - and which may be subjected to severe penalties for failing to do so - should also be entitled to recover any surplus resulting from prudent funding practices which result in such a surplus. Your proposed legislation would act as a counter-incentive to prudent funding practices, since an employer cannot recover surpluses which it might otherwise hve caused to occur. Your proposed legislation would actually encourage prudent employers to minimize plan contributions, so as to avoid creating conditions which would give rise to plan asset surpluses.

In the foregoing discussion, it is implicit that terminations may occur as a result of a number of factors not necessarily constituting "business necessity". For example, in numerous instances, defined benefit pension plans have been terminated by employers and replaced with individual account plans such as profit sharing plans at the insistence of employees who regard individual account plans as a greater incentive (and who may also believe such plans afford an opportunity to share in potentially higher earnings, particularly during a period in which market interest rates generally exceed investment assumptions made under most defined benefit pension plans). It is also a fact that defined benefit pension plans are much more expensive to maintain and to administer, and a great many defined benefit plans are terminated on account of this a multitude of other reasons which I suspect would not fall within the definition of "business necessity" as contemplated by the proposed legislation.

Any legislation such as your current proposal, which creates an enormous disincentive to employers to adopt or to maintain a defined benefit pension plan, can only result in the demise of this form of pension plan and the loss of potential benefits by large numbers of working Americans.

I strongly urge your Committee's reconsideration of the proposed legislation and would strongly oppose any legislation in this form.

Sincerely,

Michael E. Pietzsch

MEP/jvb

cc: House Select Committee On Aging
Labor Subcommittee On Labor - Management Relations

APPENDIX IV

[From the Congressional Record, June 6, 1985]

STATEMENT ON THE PLAN TERMINATION AND REVERSION CONTROL ACT OF 1985

Mr. ROYBAL. Mr. Speaker, in an attempt to address the problem of overfunded pension plan terminations by employers which deprive American workers and retirees of their retirement income security, I am today reintroducing the Plan Termination Reversion Control Act of 1985.

When would a company drop a pension plan? It's done for the money. Large numbers of pension plans are temporarily overfunded today, because the value of their investments is up, interest rates are up and employment is down. A number of companies now find themselves with more assets in their pension plans than are needed to pay vested benefits. The only way they can recapture the excess assets quickly is to terminate the plan. Companies are generally not allowed to borrow surplus from their pension plans. But the Employee Retirement Income Security Act of 1974 [ERISA] the Federal law which regulates private pension and welfare plans does not prohbit employers from terminating the plan and taking the surplus assets for their own.

According to administration figures from 1979 to January 1985, over 578 overfunded defined benefit terminations involving reversions in excess of $1 million have occurred. Nearly 700,000 workers have had their pension benefits affected by these terminations and more will be affected in the future unless Congress takes action.

In overfunded plan terminations, both employees and retirees may lose valuable retirement benefits they will need to make their retirement financially secure. For example, a 15-year employee of XYZ Corp. who plans to retire in 10 years may reasonably expect to receive pension benefits of $550 a month on retirement, as defined in the pension plan. However, as a result of the termination of the corporation's overfunded pension plan, the employee might receive a benefit of only $300 a month. Even if a new plan were initiated, it would treat this worker as a new employee, so benefits would not accrue fast enough to provide anything like the pension anticipated under the old plan. Similarly, a retiree who might anticipate an ad hoc cost-of-living increase from his employer will, after an overfunded termination, typically not receive such a cost-of-living increase because the excess assets that would otherwise fund the increase will now be taken by the employer.

Employers are terminating their pension funds to recover so-called excess assets. These are amounts which remain after all liabilities—benefits to workers—have been satisfied after the termination of the pension plan by the employer. These excess assets however, are not really excess at all but rather represent benefits which would otherwise be paid to workers but for the premature termination of the plan by the employer.

A Department of Labor study on overfunded terminations concluded that the difference to workers between an expected real benefit and a terminated nominal benefit, where there is no replacement plan, could represent approximately 45 percent of the real expected benefit. Also, under a number of different termination scenarios, workers age 45 through 65 will lose a substantial portion of their expected retirement benefit due to an overfunded plan termination because of the loss of accruals at these later ages under certain funding methods. Thus, the termination of an overfunded plan can have a devastating impact on the retirement security of a worker and his family. Moreover, retiree's would lose cost-of-living adjustments because such adjustments typically are provided through the plan's excess assets, money that will now go to the employer on termination of the plan.

PURPOSE AND BILL SUMMARY

It is the purpose of this bill to establish a Federal policy which will insure that workers and retirees are effectively protected from the loss of their pension benefits due to overfunded plan terminations which are initiated so that employers will recover excess assets. Such a Federal policy will make clear that the principle intent and purpose in establishing a pension plan and providing a tax qualified basis for the contribution and accumulation of pension assets is to provide a secure and definable retirement income for workers and their families. The continuing trend of overfunded plan terminations represents a clear and present danger to the retirement income security of workers and retirees. To better ensure the retirement security of workers and retirees from such danger, the proposed legislation establishes a number of safeguards. The bill would:

If the termination was pursued because of a bona fide "business necessity", then the employer will be able to recover excess assets, subject to a 10 percent excise tax, under certain conditions specified in the bill.

If the termination was not caused by a business necessity that it was not the result of bankruptcy, insolvency, or other business hardship, then the bill provides that the employer may still terminate the plan but any excess assets would be ratably distributed to workers who are within 5 years of normal retirement age and retirees under the plan. An excise tax of 10 percent would be imposed on any remaining amounts which are not distributed to workers and retirees.

A failure to ratably distribute to workers and retirees, as prescribed in the bill, would constitute a violation of the fiduciary provisions under title I of ERISA.

A termination which meets the business necessity test will enable an employer to establish a comparable successor plan which is similar to the terminated plan, however; such a successor plan must provide benefits—that is vesting, accrual, and dollar benefits—which are no less than those provided by the terminating plan, must provide past service credit under the comparable plan, must receive approval for an accelerated funding method for the comparable plan and must provide a cushion of assets in the comparable plan equal to 125 percent of the rate of funding under the funding standard account of the terminated plan in the year prior to its termination.

Establish a new Federal cause of action for liability for exertion of undue influence or material misrepresentation by a party in interest with respect to a fiduciary relating to a single-employer plan termination which seeks to entrench corporate management or consolidate the position of that party in interest.

Clarifies that mergers, consolidations, or transfers of plan assets must not inure to the benefit of an employer.

An application for an overfunded termination will be subject to a public hearing on the record to enable both the employer and plan participants to articulate their views regarding the pending termination application.

Certain restrictions will be placed on contributions of employer stock and other employer investment media contributed to a plan. Specifically, a plan will be able to invest no more than 5 percent in qualifying employer annuities and employer stock which is contributed may not contain features on debt when contributed to the plan.

A study will be commissioned to determine whether standards for appropriate actuarial assumptions and methods should be imposed for the funding of plans.

In a conversion from a defined benefit plan to an employee stock ownership plan [ESOP], a vote must be taken among participants to determine whether a conversion will occur.

Plans which commit an overfunded termination will be prohibited from instituting a comparable plan for a 5-year period after the termination. Certain restrictions on funding and funding deficiency waivers are also imposed on successor plans.

REVIEW OF ADMINISTRATION ACTIONS

The Reagan administration has done little to impede or resist this rising tide of plan terminations which deprive workers of needed pension benefits. In less than 5 years employer pension terminations have netted approximately $4 billion for corporations. Applications to terminate overfunded pension plans worth an additional $2 billion are pending. Hundreds of thousands of workers are affected. Issuance of new guidelines by the administration on asset reversion are not targeted to stop or resist pension raids. Rather, the guidelines offer new opportunities for corporate sponsors to accomplish plan terminations and will allow new and questionable techniques to be used to accomplish these terminations.

Overfunded pension plan terminations are not the only form of proliferating pension abuse that is growing. Increasingly, employers are contributing various forms of employer stock and other investments in lieu of cash to their pension funds. This has been particularly true in instances of corporate mergers and takeovers where stock held by the pension fund of the employer may prove to be crucial in resisting a takeover attempt. The abuse which may occur in such instances involves a loss to the plan of what the true market value of such a contribution should be and the manipulation of the pension fund to benefit the employer at the expense of the employees. The use of employee stock ownership plan's [ESOP] by employers as a device to either resist or accomplish a takeover attempt raises substantial questions under ERISA as to whether the interests of employees are well served by such actions. Moreover, restrictions on the ability of employees to vote their stock shares in ESOP's or other pension plans raise questions as to whether their interests are being adequately and appropriately represented by plan trustees.

It is now incumbent that Congress examine these growing manifestations of employer directed assaults on the security of pension benefits to workers. As the Congress has striven to provide security for workers under Social Security, it is no less important that the Congress assure workers that their pension benefits are equally secure to provide an adequate retirement income.

The House Select Committee on Aging has conducted two hearings regarding instances where workers have lost potential retirement benefits through such overfunded terminations. The first hearing, on June 7, 1982, reviewed the situation of the termination of the Harper & Row Publishers pension plan and its subsequent replacement by an employee stock ownership plan that was instituted by the management of that publisher. Present and former employees of Harper & Row testified at that time that the termination of the Harper & Row plan resulted in a loss of their retirement and resulted in significant losses of benefits due to the inordinately high 15 percent rate was applied to lump-sum distributions to many of the workers.

A second hearing held on September 28, 1983, indicated the continuing problems associated with overfunded terminations generally and examined the status of Federal law as viewed by the Department of Labor and the Internal Revenue Service on overfunded terminations. The Department of Labor testified that the decision of a plan sponsor to terminate a plan is a business decision and not a fiduciary decision covered by ERISA. The Internal Revenue Service testified that, generally, the various requirements of the Internal Revenue Code permitted the return of surplus assets after the satisfaction of all accrued benefits to participants and beneficiaries at the termination of the plan. Moreover, the Service indicated that those amounts which arose as a result of "erroneous actuarial error" were recoverable by employers under the Service's regulations. Finally, the Service testified that it was concerned about the 10 new possible arrangements for terminations involving so-called spinoff terminations and termination reestablishment cases.

Since that testimony by the Department of Labor and Internal Revenue Service to this committee, Robert A.G. Monks, Pension Administrator for the Department of Labor on April 4, 1984, before the Senate Labor Subcommittee, announced a new administration position regarding overfunded terminations. This new position provides that employers may engage in spinoff and termination reestablishment terminations. A spinoff termination involves the termination of an overfunded pension plan in which the surplus and retired participants are retained in the former plan while a new and substantially comparable successor plan is created for active participants. The former plan is then terminated so that the employer may recover any excess assets. In a termination reestablishment case, the plan, which is overfunded, is terminated by the employer to recover the excess assets and a new substantially comparable defined benefit plan is instituted to replace the former plan. Both of these methods of terminating and subsequently substituting a substantially comparable successor plan have been permitted under the administration's implementation guidelines.

The administration guidelines require that upon the termination of the plan, all participants and beneficiaries must be fully vested in their accrued benefits and that annuity contracts must be purchased for these individuals. Noticeably absent from these guidelines however, is any requirement to mandate that past service credits from the previous plan be credited to the successor plan for participants. While there is some argument that annuitization of vested credits provides some inflation protection for those vested benefits, clearly with respect to those plans in which the salary factor plays a principle role in determining benefits, final pay plans, the absence of any requirement to pick up past service credit in a successor plan will result, in some degree, in a diminution in benefits that would have otherwise been realized under the previous defined benefit plan. To this degree, and more starkly, the absence of mandated past service credits in a successor plan may well invite a reduction in absolute terms of projected benefits that could have been earned under the previous plan. Moreover, for a less altruistic employer, the absence of mandated past service credit may represent an open invitation to diminish benefits in any successor plan that might be instituted by the employer.

A group of tax attorneys who had petitioned the Internal Revenue Service and the Pension Benefit Guaranty Corporation to utilize the spinoff method of termination, had provided in their submission that a "cushion" of excess assest be carried into the successor plan, ostensibly to protect against a shortfall in funding in early years and to provide some modicum of protection to the Corporation in its responsibility to the successor plan. However, the administration did not see fit to include a requirement for a cushion within its guidelines. Rather, after some review, it was apparently felt that the annuitization of accrued benefits and the minimum funding standards would be sufficient to protect future benefit accruals and provide sufficient insulation of the Corporation with respect to the successor plan. It is problematic however, that the annuitization and minimum funding standards will provide sufficient protection particularly for the Corporation in the event that a termination of a successor plan occurs in years shortly after the creation of the successor plan. Moreover, it is also reasonable to assume that at any point at which interest rates and other markets decline and affect the actuarial liabilities of the plan, that the administrations guidelines will not provide a sufficient buffer to insure an adequate and solvent funding of the plan under those circumstances, particularly within the early years of the successor plan's creation.

An abuse noted in previous committee hearings and recognized as an issue within the administration guidelines has been the use of inordinately high interest rates applied to lump-sum distributions made to participants upon termination. Testimony by one witness before the committee indicated that based upon his 12 years of service with Harper & Row Publishers he had received a lump-sum distribution of approximately $700 for his accrued benefit. Upon seeking a life annuity from an insurance carrier however, he received a quote of approximately $7,000 to secure such an annuity. The administration has responded to this abuse by promulgating a regulation that requires an interest rate be used which approximates a market or annuity rate. While the new rate set by the Corporation will more closely align within prevailing market interest rates, such a formulation however, still falls short of the most accurate barometer of accrued benefits, the use of an annuity interest rate to determine lump-sum amounts.

The use of the spinoff and termination reestablishment techniques and certain other requirements which are embodied in the administration guidelines raise significant questions regarding the authority under ERISA and the code to permit such arrangements. One threshold problem involves an apparent lack of authority under the code and title IV of ERISA to prescribe certain conditions attending a spinoff and termination reestablishment. The use of the spinoff and termination reestablishment techniques directly undermine the minimum funding standards prescribed under title I and II of ERISA. No exception of limitation is provided within those provisions to permit a redefinition or reorientation of the specific requirements of funding in the manner constrained through spinoff and reestablishment terminations. Moreover, there would appear to be little or no authority within the fabric of title IV upon which the Corporation could authorize the use of these techniques. The requirement that a plan sponsor could not engage in another termination and subsequent reestablishment of a defined benefit plan within a 15-year period is not specifically prescribed in either the code or title IV of ERISA, but rather it appears to be based on the 15-year requirement to amortize experience gains. Basically, the administration guidelines in this area simply undercut the policy and requirements of minimum funding under ERISA making null and void the need to preserve reserves of funding to protect participants, plan sponsors and the Corporation. The policy of the guidelines in this area simply cede to the employer any surplus through plan termination with little or no recognition of the policy objectives and requirements respecting minimum funding.

In recent correspondence between the Select Committee and the Department of the Treasury, it has become clear that the administration views the guidelines as merely a statement of enforcement policy rather than a substantive set of rules controlling plan asset reversions upon termination. Such a view makes clear that the guidelines need not be observed by a court and, in fact, the guidelines are presently being challenged in the courts by two plan sponsors, Celanese Corp. and Interco, Inc., who contend that certain specific requirements of the guidelines lack an appropriate statutory basis. These contentions by plan sponsors mirror closely the previously enunciated concerns of the Aging Committee in correspondence to the Treasury Department and the Pension Benefit Guaranty Corporation. The outcome of these pending lawsuits may well portend the demise of an enforcement strategy which held little statutory credence.

A significant area without guidance in the guidelines involves tax policy and the opportunity for tax abuse through overfunded terminations. The Committee on Aging has written extensively to the Service inquiring whether, in their opinion, opportunities for tax abuse exist within the present structure of overfunded terminations which have occurred to date. The responses of the Service had largely been unedifying on this topic until recently. It is clear that an employer through the recapture of excess assets has received a tax deduction for contributions and an exemption for interest and dividends realized on plan assets. This preferred tax treatment is accorded to encourage the establishment and presumed maintenance of permanent programs of pension benefits to provide retirement income security to workers covered under these programs. An employer who is recapturing excess assets is reaping a significant tax benefit even assuming the reversion is included as income to the employer. An employer in a position to offset any tax liability with respect to the reversion through tax loss carryforward may significantly defray or entirely eliminate and tax liability that would otherwise result from the reversion. Such a result can be analogized to other abusive tax treatments of investments which have been the concern of both the administration and the Service in other areas. Simply, some employers may have treated their tax qualified pension plan as merely a tax-free corporate-savings device. In its most recent revised tax plan, the Department of the Treasury is seeking the imposition of a 10-percent excise tax on any asset reversion arising out of a plan termination. This position was taken by the Treasury Department in recognition of the favorable tax treatment accorded to pension plan contributions that would otherwise inure to the benefit of an employer at termination, but for the imposition of the excise tax to recover amounts which should be taxed.

Perhaps the single greatest failure of the administration guidelines is that they fail to address the basic concern implicit in overfunded terminations. That is, that as a matter of public policy the failure to in any way inhibit or control overfunded terminations serves to erode the basic Federal policy supporting the establishment and maintenance of pension plans, which is to provide a secure reservoir of moneys to provide retirement income to workers.

Recent data derived from the Pension Benefit Guaranty Corporation [PBGC] indicate that, after the issuance of the administration guidelines in May 1984, the number of overfunded defined benefit plan terminations has substantially increased. PBGC data indicate that an estimated 279 plans, each with over $1 million in exces assets reverting to the employer, were to be terminated in 1984. This number of terminations is comparable to the total of all such terminations, 284, for the previous 5 years, 1979–83. It is also notable that the total of excess assets to be reverted to employers for 1984 is expected to exceed $3 billion, this compared with $2.14 billion for the period of 1979 through 1983. The data also indicates that the average reversion to the employer has substantially increased. For example, in 1980, the average reversion from an individual plan was approximately $2.1 million. By 1984, this figure has grown to approximately $11.3 million per terminated plan.

The majority of these terminations have been taken not because of a financial necessity of that employer but, rather, because the employer desired to obtain a reversion to accomplish some business purpose which might include preventing or sponsoring a takeover, improving the financial statements of that employer, or using the reversion of finance the acquisition of employer stock. While some commentators may believe that the use of a reversion in this manner is not an appropriaste subject to review in the context of setting policy on employee pension plans, it would seem imperative that such a review is incumbent at this point, to ensure that appropriate safeguards are provided to assure employee benefit security. Presently, there are pending applications for overfunded terminations—involving reversions of $1 million or more—which are rapidly approaching $1 billion. The issuance of administration guidelines, which sanction the use of spinoff and termination reestablishment techniques, woud seem to provide a fertile environment to enage further overfunded terminations, Morevover, the convenience of the termination vehicles available within the administration guidelines provide an easier mechanism to accomplish a plan asset reversion, that those methods previously sanctioned by the agencies.

DISCUSSION OF BILL

One provision of the bill would have the effect of prohibiting the use of so-called spinoff and termination reestablishment overfunded plan terminations, As indicated earlier, a spinoff termination involves the creation of a second and comparable defined benefit plan in which the active participants of the former plan are placed. The former defined benefit plan retains only retired participants—that is, participants who are already in pay status under the plan—and any surplus plan assets which exist in the plan. The employer typically purchases annuity contracts for retired participants and obtains a reversion of excess assets upon the termination of that former plan. Thereupon, only the active employers are retained in the subsequent successor plan which is substantially comparable to the terminated plan. With respect to a termination reestablish arrangement, a defined benefit plan covering employees is wholly terminated and a reversion is taken by the employer upon the termination of that plan. Subsequently, a new and substantially comparable defined benefit plan is created to cover the same group of employees.

In both instances, these arrangements present significant difficulties with compliance with the minimum funding standards of ERISA. However, the bill would permit the use of a spinoff or reestablishment termination where a comparable successor plan was established, only in the instance where the plan sponsor has received a business necessity determination from the Pension Benefit Guaranty Corporation. The ability to establish a comparable successor plan, in an instance of business necessity, is taken in recognition that the employer not be penalized from maintaining a similar and consistent pension benefit program for his employees under this business exigency. However, to utilize such a comparable successor plan, the plan sponsor must meet certain conditions which include that: First, the benefit structure for the successor plan be equal to or greater than the benefit structure under the terminated plan, second, that there be a cushion of assets placed into the successor plan which equal 125 percent of the minimum funding requirement of the terminated plan in the plan year prior to its termination, third, that the plan obtain approval for an accelerated funding schedule to fund a successor plan, fourth, that no funding deficiency waiver be granted during the period of accelerated funding for the plan and fifth, in the case of a spinoff the comparable successor plan retains the same benefit structure as the original plan and such benefits are not reduced or otherwise amended at any time during the accelerated funding period. Terminations which did not receive a notice of business necessity from the corporation would be prohibited from instituting a comparable plan for a period of 5 years. Specifically, no comparable successor plan could receive tax qualification for a 5-year period.

The bill describes the various tests which must be applied concerning the distribution of excess assets upon the termination of an overfunded defined benefit pension plan. In the first instance, any residual assets which are attributable to employee contributions shall be equitably redistributed to those employees.

A rule has been provided requiring that 50 percent of the remaining residual assets will be distributed to retirees in pay status and 50 percent will be distributed to those participants who are within 5 years of the normal retirement age under the plan. This rule is added to provide some modicum of financial protection for those individuals who are approaching retirement and retirees who would otherwise be deprived of benefit security through an overfunded termination due to the loss of ad hoc cost-of-living adjustments. Specifically, these individuals will now through operation of the rule, receive additional benefits which will more closely approximate promised benefits under the plan and for retirees provide needed cost-of-living protection that could have been afforded through the existence of overfunded amounts.

With respect to amounts distributed to participants and beneficiaries who are already in pay status with respect to the plan, such a distribution shall be equal to that participant's or beneficiary's unpaid constructive cost-of-living increase. The term "unpaid constructive cost-of-living increase" is defined as the amount of such participant's benefits which would be remaining unpaid, after satisfaction of the liabilities of the plan to such participant or beneficiary as if general cost-of-living increases had taken effect under the plan. This section requires that in order to have such a distribution no cost-of-living increase would have been granted to retirees within the last 5 years preceding the termination of the plan. The cost-of-living adjustment shall be measured based upon an annual rate equal to a measure of the Consumer Price Index as prepared by the U.S. Department of Labor for the appropriate period.

With respect to any participants who have not received benefits, but who are within 5 years of the normal retirement age under the plan as of the termination date, such participants will receive ratable distributions. Such benefits will be measured based upon the present value of benefits prior to the termination of the plan and in a manner as if the plan had not been terminated and the participant had continued to accrue additional benefits under the plan and attain the normal retirement age. In this manner, the participant will receive some additional benefits toward what he would have otherwise earned under the plan but for the premature termination of that plan. However, amounts distributable under this section are premised on the amount of available assets remaining to satisfy these benefits and, to the extent that assets are less than those needed to provide full benefits under this section, such remaining amounts will be distributed on a prorated basis.

In each instance where there is a required distribution of excess assets to a specific class, if assets prove to be insufficient to meet a full distribution to all members of that class, then an equal and prorated distribution shall be made to all members of that class so as to absorb all remaining assets for that class.

A special rule is provided such that if benefits between any class, those who are within 5 years of the normal retirement age under the plan and retirees who are in pay status, would fall below 75 percent of the benefit provided to the other class, the

Commission will be granted discretion to redistribute such amounts from the other class so as to assure that benefits do not fall below the threshold of 75 percent between the two classes.

A plan which is in effect on the date of enactment of this law shall be considered to meet the requirements of the law if within 60 days after enactment, provisions of that plan contain provisions which have been previously described. Generally, the provisions of this subsection will constrain that all excess assets which are the result of an overfunded termination that does not meet the requirements of a business necessity termination shall be used for the satisfaction of benefit payments to retirees and participants who are within 5 years of retirement under the plan. It shall be the responsibility of the Commission which is created under the law to promulgate appropriate regulations to interpret and enact the provisions of this law.

An excise tax is imposed in any situation where an employer receives excess assets upon an overfunded pension plan termination. This requirement mirrors the proposal of the Treasury Department under its revised tax plan which also would impose a 10-percent excise tax on all such reversions to employers.

With respect to an application for termination of an overfunded plan, the bill provides that a hearing on the record be held by the Commission to determine whether or not the termination should be granted. The hearing will afford plan participants, retirees, plan officials and other interested parties an opportunity to express their views and concerns regarding the application for termination of the overfunded plan. In addition, such a hearing will better enable members of the Commission to define and understand those issues pertinent to the application for termination.

The bill establishes the new Federal cause of action wherein a fiduciary exerts or attempts to exert an undue influence or perpetrate a material misrepresentation to accomplish the entrenchment of a corporate management, typically related to an offensive or defensive posture related to a corporate takeover attempt.

Provisions of the bill make several significant changes to the manner in which employer securities are treated under ERISA. In recent years there has been a growing trend of contributions in kind—contributions of employer stock, leaseholds, limited partnerships, and so forth—by employers into their pension funds. Pension and Investment Age magazine has estimated that over one 18-month period employers contributed in excess of $1.8 billion in the form of stock or other contributions in kind. There is every reason to believe that such contributions will continue and, in fact, have escalated over the last several years.

Contributions in kind raise a number of significant questions regarding their propriety and acceptability with respect to certain goals which are sought under ERISA. One of the immediate concerns raised by a contribution in kind is the appropriate valuation of such a contribution into the pension fund. While a number of large employers have striven to assure that an appropriate value was placed on a contribution into the plan, other small and close corporations may not attempt to assure the appropriate valuation of such contributions. If the value of the contribution does not reflect the value of the required contribution to the plan, then there is a potential that the plan will become underfunded. Moreover, with respect to the deduction taken by the employer for such a contribution, if the true value is not reflected by the actual contribution then a form of tax abuse has occurred with respect to such a contribution.

Additional problems are presented in instances where the employer reserves or otherwise restricts the voting rights of stock which have been contributed to the pension fund. In such instances, management may seek to consolidate its position through exercise of voting rights held by the plan. Such an exercise by management may be antithetical to the interests of participants covered under the plan. The Department of Labor's interpretation of relevant provisions of the prohibited transaction provisions would not appear to clearly delineate and prohibit the exercise of voting rights in such instances.

Finally, the growing use of contributions in kind as a funding medium, generally, present an opportunity for a loss of security in the manners described above. For this reason, the threshold of qualifying securities or real property is lowered from 10 percent to 5 percent under the bill. This will better ensure that additional protection is afforded through this lowered limitation for contributions and appropriate transitional rules are provided to achieve the lowered threshold.

Provisions of the bill in this section provide that any qualifying employer stock contributed to a plan not be encumbered by a bond, debenture, note, certificate, or any other evidence of indebtedness. Moreover, such a contribution may not be subject to any restriction on its marketability or on any voting power attached to the contribution. These restrictions will better assure that the interests of plan participants remain clear and unfettered by ancillary concerns which could be raised by management. In addition the Secretary of Labor shall promulgate regulations which will define a method of determining the fair market value of stock or other contributions which are contributed to a pension plan.

There are provisions in the bill concerning a study which will be conducted by the Joint Board for the Enrollment of Actuaries. The bill would require that the Joint Board conduct a study to determine reasonable actuarial assumptions and methods that could be prescribed for various types of pension plans. Upon completion of this study, after a 2-year period, a report would be prepared and submitted to the appropriate committees of the Congress to determine whether any legislative reforms will be needed based upon the report.

This study would be undertaken in response to concerns that certain actuarial, assumptions and methods that are presently applied to some pension plans are inappropriate and/or produce actuarial assumptions which cannot be sufficiently justified under prevailing market conditions and reasonable actuarial projections. Moreover, there is a concern that code provisions which grant the Internal Revenue Service authority to review the actuarial assumptions adopted to plans may not be sufficiently stringent to assure the adequate funding of plans and the appropriate use of reasonable actuarial assumptions with respect to any given plan. It would appear to be reasonable, given the absence of appropriate standards of guidelines associated with the use of actuarial assumptions and methods within the profession, to examine and make determinations with respect to whether appropriate guidance should be applied in this area. Moreover, it would appear to be appropriate to invest the Joint Board with responsibility to conduct this study, make recommendations, and if determined necessary, provide authority for the Joint Board to supervise the imposition of such appropriate standards.

With respect to employee stock ownership plans [ESOP], provisions of the bill would require that in any transfer of assets from a terminated plan to an ESOP, such a transfer must be approved in advance in writing by the participants in the terminated plan; that the proportion of voting rights remain equal to or no less than those rights existing prior to the termination of the pension plan.

This provision is included to better assure that the interest of participants, with respect to their voting of shares in an ESOP, is adequately protected through their ability to vote those shares. Moreover, the ability of participants to vote their shares will afford some protection against the ability of management to attempt to entrench itself or otherwise act in a manner which might be adverse to the interests of participants covered under the plan.

Certain restrictions are placed on the reestablishment or re-creation of a comparable plan after the termination of an overfunded plan which is not based on business necessity as formulated in the bill. Specifically, a plan which is terminated without business necessity is disqualified for a period of 5 years from establishing a comparable plan within the period. In addition, no funding deficiency waiver may be granted to a successor plan within 10 years after the termination of a plan which was not based on business necessity. With respect to the creation of a comparable successor plan after a termination for business necessity, no funding waiver may be available within 5 years of the termination of the former plan. Moreover, comparable restrictions are provided with respect to any extension of the amortization period in a manner similar to the restrictions discussed above. In addition, if a comparable plan is established within 5 years of the termination, a faster funding period is required for such a comparable plan to better assure adequate funding for future benefits.

The bill provides that the Pension Guaranty Benefit Corporation will administer the various provisions regarding terminations of sufficient over-funded plans and provides new authority for the PBGC to protect the interests of plan participants and retirees through new causes of action available under title I of ERISA which enable it to specifically enforce its authority in these various areas.

CONCLUSION

This bill is introduced with the intent not only to provide substantive standards to control and inhibit overfunded terminations, but, is also offered as a basis for discussion to attempt to arrange a framework which will better assure the retirement security of workers and retirees under such terminations. I solicit comments and views on this proposed legislation.

99TH CONGRESS
1ST SESSION

H. R. 2701

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to provide for additional and more effective controls on terminations of single-employer plans and reversions to employers resulting from such terminations.

IN THE HOUSE OF REPRESENTATIVES

JUNE 6, 1985

Mr. ROYBAL (for himself, Mr. SKELTON, Mrs. COLLINS, Mr. BIAGGI, Mr. MITCHELL, Mr. ST GERMAIN, Mrs. SCHROEDER, Mr. STOKES, Mr. VENTO, Mr. MACKAY, Ms. OAKAR, Mr. PEPPER, Mr. CROCKETT, Mr. FORD of Tennessee, Mr. DYMALLY, and Mr. TOWNS) introduced the following bill; which was referred jointly to the Committees on Education and Labor and Ways and Means

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A BILL

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to provide for additional and more effective controls on terminations of single-employer plans and reversions to employers resulting from such terminations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

This Act may be cited as the "Plan Termination and Reversion Control Act of 1985".

TABLE OF CONTENTS

Sec. 1. Short title and table of contents.
Sec. 2. Application of fiduciary duty to mergers and consolidations of plans and transfers of plan assets or liabilities.
Sec. 3. Fiduciary responsibility and plan termination.
Sec. 4. Limitation on distributions to employers of residual assets after single-employer plan termination.
Sec. 5. Notice of intent to file for single-employer plan termination.
Sec. 6. Effect of plan reversions to employers on ability to obtain qualification of replacement plans, on funding requirements, and on ability to obtain funding waivers and amortization extensions.
Sec. 7. Excise tax on reversions to employers upon termination of single-employer plans.
Sec. 8. Requirements relating to employer securities acquired or held by plans.
Sec. 9. Prescription by Joint Board for the Enrollment of Actuaries of reasonable actuarial assumptions and methods.
Sec. 10. Voting rights of participants in employee stock ownership plans to which assets are transferred upon plan termination.
Sec. 11. Effective date; constructive date of filing of notices of plan terminations.

SEC. 2. APPLICATION OF FIDUCIARY DUTY TO MERGERS AND CONSOLIDATIONS OF PLANS AND TRANSFERS OF PLAN ASSETS OR LIABILITIES.

(a) AMENDMENT OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(1) IN GENERAL.—Section 208 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1058) is amended to read as follows:

"MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS OR LIABILITIES

"SEC. 208. (a) A pension plan may not be merged or consolidated with, and its assets or liabilities may not be transferred to, any other pension plan, unless—

"(1) each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated), and

"(2) any act or failure to act in accomplishing the merger, consolidation, or transfer would not constitute a violation of section 403(c)(1).

"(b) Subsection (a)(1) shall not apply to any transaction to the extent that participants either before or after the transaction are covered under a multiemployer plan to which title IV of this Act applies.".

(2) CLERICAL AMENDMENT.—The item relating to section 208 in the table of sections in section 1 of such Act is amended by inserting "or liabilities" before the period.

(b) AMENDMENT OF THE INTERNAL REVENUE CODE OF 1954.—Subsection (l) of section 414 of the Internal Revenue Code of 1954 (relating to mergers and consolidations of plans or transfers of plan assets) is amended to read as follows:

"(l) MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS OR LIABILITIES.—

"(1) IN GENERAL.—A trust which forms a part of a plan shall not constitute a qualified trust under section 401 and a plan shall be treated as not described in section 403(a) unless, in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other trust plan—

"(A) each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated), and

"(B) any act or failure to act in accomplishing the merger, consolidation, or transfer would not constitute a violation of section 403(c)(1) of the Employee Retirement Income Security Act of 1974.

"(2) EXCEPTION.—Paragraph (1)(A) shall not apply to any transaction to the extent that participants either before or after the transaction are covered under a multiemployer plan to which title IV of the Employee Retirement Income Security Act of 1974 applies.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to mergers and consolidations of plans, and transfers of assets or liabilities between plans, occurring on or after the date of the enactment of this Act.

SEC. 3. FIDUCIARY RESPONSIBILITY AND PLAN TERMINATION.

(a) Fiduciary Responsibility for Meeting Requirements Relating to Distribution of Residual Assets Upon Termination.—Subsection (a) of section 406 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1106(a)) is amended by adding at the end thereof the following new paragraph:

"(3) In any case in which a single-employer plan terminates under section 4041 and it is determined that residual assets of the plan have been distributed pursuant to the termination in a manner or extent in violation of the requirements of section 4044(d), any person who was a fiduciary who had authority or discretion to control or manage the assets of the plan and permitted such violation to occur shall be treated as having breached a fiduciary duty.".

(b) Fiduciary Responsibility in Connection with Related Plans Following Plan Terminations.—Section 403(c) of such Act (29 U.S.C. 1103(c)(1)) is amended by adding at the end thereof the following new paragraph:

"(5) Any failure to meet the requirements of section 401(a)(25)(B) of the Internal Revenue Code of 1954 in the case of a replacement plan (as defined in section 401(a)(26)(C) of such Code) after a single-employer plan termination under section 4041 shall be treated as a failure to meet the requirements of paragraph (1).".

(c) LIABILITY FOR EXERTION OF UNDUE INFLUENCE ON FIDUCIARIES RELATING TO PLAN TERMINATION.—

(1) IN GENERAL.—Part 4 of subtitle B of title I of such Act is amended—

(A) by redesignating sections 413 and 414 as sections 414 and 415, respectively; and

(B) by inserting after section 412 the following new section:

"LIABILITY FOR EXERTION OF UNDUE INFLUENCE ON FIDUCIARIES RELATING TO SINGLE-EMPLOYER PLAN TERMINATION.

"SEC. 413. (a) It shall be unlawful for any individual who is a party in interest described in subparagraph (B), (C), (D), (E), (H), or (I) of section 3(14) in connection with a pension plan (other than a multiemployer plan) to take, or fail to take, any action with the intent to exert undue influence on, or to cause a material misrepresentation to, a fiduciary of the plan, if a purpose of such exertion of undue influence or misrepresentation is to initiate or facilitate a termination of the plan in order to entrench or otherwise protect the status of such individual on the basis of which such individual is a party in interest,

"(b) The Pension Benefit Guaranty Corporation may assess a civil penalty against any person who commits a violation described in subsection (a). The amount of such penalty may not exceed 5 percent of the amount of any distribution from the plan to the employer pursuant to section 4044(d)(1)(D). Such person shall also be personally liable to make good to any aggrieved participant or beneficiary losses to such participant or beneficiary resulting from such violation. Liability for any violation described in subsection (a) shall be joint and several.".

(d) RIGHTS OF ACTION BY THE CORPORATION.—Section 502(a) of such Act (29 U.S.C. 1132(a)) is amended—

(1) in paragraph (5), by striking out "or" at the end thereof;

(2) in paragraph (6), by striking out "subsection (i)." and inserting in lieu thereof "subsection (i); or"; and

(3) by adding after paragraph (6) the following new paragraph:

"(7) by the Pension Benefit Guaranty Corporation—

"(A) for appropriate relief under section 409 in the case of breaches described in section 406(a)(3), or

"(B) in the case of a violation described in section 413(a), (i) to enjoin any act or practice constituting such violation, or (ii) to obtain other appropriate equitable relief (I) to redress such violation, or (II) to enforce such section.".

SEC. 4. LIMITATION ON DISTRIBUTIONS TO EMPLOYERS OF RESIDUAL ASSETS AFTER SINGLE-EMPLOYER PLAN TERMINATION.

(a) IN GENERAL.—Section 4044 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1344) is amended by striking out subsection (d) and inserting in lieu thereof the following new subsections:

"(d) TREATMENT OF RESIDUAL ASSETS.—

"(1) PRIORITY AND MANNER OF DISTRIBUTION.—In any case in which all liabilities of the terminated plan to participants and their beneficiaries have been satisfied, the residual assets of the plan shall be distributed as follows:

"(A) ASSETS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—Any residual assets of the plan attributable to employee contributions shall be equitably distributed to the employees who made such contributions (or their beneficiaries) in accordance with their rate of contributions. For purposes of this subparagraph, unless the corporation approves by regulation an alternative method of computation, the portion of the residual assets which are attributable to employee contributions shall be conclusively presumed to be an amount which bears the same ratio to the total amount of residual assets as the total assets of the plan allocated under paragraph (2) of subsection (a) bears to the total assets of the plan allocated under paragraphs (2) through (6) of subsection (a).

"(B) REMAINING RESIDUAL ASSETS AVAILABLE TO COMPENSATE FOR UNPAID CONSTRUCTIVE COST-OF-LIVING INCREASES AND PROXIMITY TO RETIREMENT AGE.—Except in cases of increased availability to employers of residual assets under subsection (e), any residual assets of the plan remaining after application of subparagraph (A) shall be distributed as follows:

"(i) COMPENSATION FOR UNPAID CONSTRUCTIVE COST-OF-LIVING INCREASES.—

"(I) IN GENERAL.—50 percent of such remaining residual assets shall be available for distribution to the participants and beneficiaries with respect to whom benefit payments have commenced under the plan before the termination date, in an amount with respect to each such participant or beneficiary equal to the participant's or beneficiary's unpaid constructive cost-of-living increase.

"(II) UNPAID CONSTRUCTIVE COST-OF-LIVING INCREASE.—For purposes of this clause, the participant's or beneficiary's unpaid constructive cost-of-living increase is the amount of such participant's or beneficiary's benefits which would be remaining unpaid, after satisfaction of the liabilities of the plan to such participant or beneficiary as determined without regard to this subsection, if general cost-of-living increases had taken effect under the plan, during the period beginning with the fifth plan year preceding the termination date, with respect to benefits payable under the plan so that benefit payments becoming payable during such period had subsequently increased at an annual rate equal to the annual rate of increase in the Consumer Price Index (as prepared by the Department of Labor) during such period, together with interest computed on such unpaid amount.

"(ii) COMPENSATION FOR PROXIMITY TO RETIREMENT.—50 percent of such remaining residual assets shall be available for distribution to the participants with respect to whom payment of benefits has not commenced under the plan as of immediately before the termination date but who are within five years of normal retirement age under the plan as of the termination date, in an amount with respect to each such participant equal to the excess of—

"(I) the present value (as of the termination date) of the pension benefits to which the participant would be entitled under the plan (as in effect immediately before the termination date) if such plan were not terminated and such participant continued to earn annually until the normal retirement age the same rate of compensation upon which the participant's benefits would be computed under the plan if the participant attained the normal retirement age on the termination date and retired on such date, over

"(II) the liabilities of the plan to the participant as determined without regard to this subsection.

"(iii) REVERSION OF EXCESS TO EMPLOYER.—Any amount of such residual assets which are available for distribution under clause (i) or (ii) and which remain after the distribution under such clause shall be distributed in accordance with subparagraph (D).

"(C) ADJUSTMENTS TO AMOUNTS OF RESIDUAL ASSETS DISTRIBUTABLE TO PARTICIPANTS AND BENEFICIARIES.—

"(i) PRORATION OF AVAILABLE ASSETS.—Except as provided in clauses (ii) and (iii), in any case in which residual assets are available for distribution under subparagraph (A), (B)(i), or (B)(ii) but are insufficient to fully meet the requirements of such subparagraph, such assets shall be distributed under such subparagraph in amounts prorated on the basis of the formula described in such subparagraph.

"(ii) REALLOCATION OF EXCESS AVAILABLE ASSETS.—In any case in which—

"(I) residual assets are distributed under subparagraph (B),

"(II) the amount available for distribution under either of clauses (i) and (ii) of subparagraph (B) is in excess of the amount necessary to make all distributions required under such clause, and

"(III) the amount available for distribution under the other of such clauses of subparagraph (B) is (before application of this clause) subject to proration under clause (i),

such excess amount shall be treated as available for distribution under such other clause.

"(iii) ADJUSTMENT TO ENSURE EQUITABLE DISTRIBUTION.—In any case in which—

"(I) residual assets are distributed under subparagraph (B),

"(II) the distribution under clause (i) or (ii) (or both) of subparagraph (B) is subject to proration under this subparagraph, and

"(III) the ratio (expressed as a percentage) of the average amount each participant or beneficiary referred to in either of clauses (i) and (ii) of subparagraph (B) would receive (but for this clause) under subparagraph (B) and this subparagraph to the average amount each participant or beneficiary referred to in the other of such clauses of subparagraph (B) would receive (but for this clause) under subparagraph (B) and this subparagraph is less than 75 percent,

then the corporation shall reallocate such assets distributed under subparagraph (B) among all such participants and beneficiaries referred to in subparagraph (B) so that such reallocation differs from the allocation which would have been made (but for this clause) under subparagraph (B) and this subparagraph only to the extent necessary to ensure that such ratio is increased to a percentage as near as practicable to 75 percent.

"(D) REVERSION OF REMAINING RESIDUAL ASSETS TO EMPLOYERS.—Any residual assets of the plan remaining after application of the preceding provisions of this paragraph shall be distributed to the employer if—

"(i) the distribution to the employer does not contravene any applicable provision of the laws of the United States or of any State (within the meaning of section 3(10)), and

"(ii) the plan has, since its establishment, provided explicitly for such a distribution in these circumstances.

A plan in effect on the date of the enactment of the Plan Termination and Reversion Control Act of 1985 shall be considered to meet the requirements of clause (ii) if it has contained the provision described in clause (ii) since such date or any date within 60 days after such date. For purposes of the preceding sentence, a plan shall be treated as containing such provision only if the plan administrator notifies in writing each employee or retiree who qualifies as an interested party (within the meaning of section 7476(b)(1) of the Internal Revenue Code of 1954) of the proposed plan amendment incorporating such provision not later than 30 days before the date of its adoption.

"(E) SPECIAL RULE IN CASES OF TRANSFERS OF COVERAGE TO OTHER PLANS.—If, in the course of the termination of a single-employer plan, assets or liabilities of the plan are transferred to any other plan and the requirements of subsection (f)(3)(D) are met, the portion of any residual assets of the terminated plan which (but for this subparagraph) would be required under subparagraph (B)(ii) or (C) to be distributed to a participant or beneficiary referred to in subparagraph (B)(ii) who becomes by reason of such transfer a participant or beneficiary under such other plan shall not be so distributed and shall be available for distribution under subparagraph (D) (if otherwise permitted under subparagraph (D)).

"(F) TREATMENT OF REMAINING ASSETS.—Any residual assets of the plan which remain after application of subparagraphs (A), (B), and (C) and which are not distributable under subparagraph (D) shall be distributed to the participants and beneficiaries in the same proportions as assets of the plan are allocated to the benefits of such participants and beneficiaries in satisfying such liabilities and in making distributions under subparagraphs (A), (B), and (C).

"(2) REGULATIONS.—

"(A) IN GENERAL.—The corporation shall issue regulations prescribing the manner in which distributions under paragraph (1) shall be made.

"(B) CONSIDERATION OF ADMINISTRATIVE COSTS; WAIVERS.—The regulations prescribed pursuant to subparagraph (A) shall provide for consideration of the administrative costs to the plan of a distribution in accordance with subparagraph (A), (B), (C), (D), or (E) of paragraph (1) in determining the availability of residual assets for purposes of such distribution. Such regulations may provide for waivers by the corporation, individually or by class, of the requirements for a distribution provided under subparagraph (A), (B), (C), (D), or (E) of paragraph (1) upon a determination by the corporation that the administrative costs to the plan renders the distribution impracticable.

"(e) INCREASED AVAILABILITY TO EMPLOYERS OF RESIDUAL ASSETS UPON CERTIFICATION OF BUSINESS NECESSITY.—

"(1) IN GENERAL.—During the 90-day period referred to in section 4041(a), the corporation shall determine whether the proposed termination is a business necessity (within the meaning of subsection (f)) and, subject to the requirements of paragraph (2), provide the plan administrator with certification of such determination. If the corporation provides the plan administrator with such certification, subsection (d)(1)(B) shall not apply with respect to such plan.

"(2) NOTICE AND OPPORTUNITY FOR HEARING.—The corporation shall not issue the certification pursuant to paragraph (1) until after the corporation has provided each participant, beneficiary, and fiduciary of the plan 30 days notice and opportunity for a hearing on the record (including submission of written testimony) concerning the corporation's determination. The plan administrator of the plan with respect to which the notice that the plan is to be terminated is filed under subsection (a) shall be required to appear at any such hearing, and the corporation shall allow the participants and beneficiaries, the employer, the Secretary of Labor, their representatives, and any other interested parties to appear at such hearing or to submit their written comments regarding the proposed termination. After such notice and opportunity for hearing has been provided, the corporation's preliminary determination, as affirmed or modified after such hearing, shall be the final decision of the corporation upon which the corporation may base certification under paragraph (1). No action to distribute plan assets may proceed until the requirements of this paragraph have been met.

"(3) CERTIFICATION REQUIREMENTS IN ABSENCE OF CERTIFICATION OF BUSINESS NECESSITY.—If the corporation determines that the requirements for a determination that the proposed termination is a business necessity are not met, the plan administrator shall submit to the corporation, not later than 360 days after the date on which the corporation provides the plan administrator notification under section 4041(b) (relating to notification of sufficiency), certification by an enrolled actuary that the residual assets subject to distribution under subsection (d)(1)(B) have been distributed in accordance with subparagraphs (B) and (C) of subsection (d)(1). Failure by the plan sponsor to submit such certification to the corporation may be considered by the corporation grounds for cessation of activities undertaken to terminate the plan and restoration of the plan under section 4047.

"(f) RULES GOVERNING DETERMINATIONS OF BUSINESS NECESSITY.—

"(1) IN GENERAL.—Subject to paragraphs (4) and (5), a plan termination is a business necessity if the requirements of paragraph (2) or (3) are met with respect to the termination.

"(2) DISTRESS REQUIREMENTS.—The requirements of this paragraph are met if the requirements of at least one of the following subparagraphs have been met:

"(A) RECENT FUNDING WAIVERS.—The requirements of this subparagraph are met if a waiver of the minimum funding standard was granted under section 303 of this Act or 412(d) of the Internal Revenue Code of 1954 to the terminated plan with respect to not fewer than 3 of the 5 plan years immediately preceding the termination date, and such a waiver has also been granted, with respect to at least 1 of the 3 plan years immediately preceding the termination date, to each other single-employer plan of which any of the contributing sponsors of the terminated plan or the substantial members of their controlled groups (if any) is a contributing sponsor.

"(B) LIQUIDATION IN BANKRUPTCY OR INSOLVENCY PROCEEDINGS.—The requirements of this subparagraph are met if each of the contributing sponsors and the substantial members of their controlled groups (if any) had filed or had had filed against him as of the termination date a petition seeking liquidation in a case under title 11, United States Code (or under any similar law of a State or political subdivision of a State) which had not, as of the termination date, been dismissed or converted to a case under chapter 11 of such title (or under any similar law of a State or political subdivision of a State) in which reorganization is sought.

"(C) INABILITY TO PAY DEBTS AND CONTINUE IN BUSINESS.—The requirements of this subparagraph are met if a contributing sponsor shows by substantial evidence that, had termination not occurred, the contributing sponsors and the substantial members of such sponsors' controlled groups (if any) would each have been unable to pay their respective debts when due and would have been unable to continue in business.

"(D) UNREASONABLY BURDENSOME PENSION COSTS CAUSED BY DECLINING WORKFORCE.—

"(i) IN GENERAL.—Subject to clause (v), the requirements of this subparagraph are met if, as determined under regulations of the corporation, solely as a result of a decline in the work force covered as participants under the plan, the contribution-wage ratio for the plan year of the terminated plan in which the termination date occurred and the contribution-income ratio for such plan year are each at least twice the corresponding ratio for the relevant preceding plan year.

"(ii) CONTRIBUTION-WAGE RATIO.—The contribution-wage ratio is the ratio of—

"(I) the total required contributions under all single-employer plans of which the persons who were contributing sponsors of the terminated plan or members of such sponsors' controlled groups (if any) were contributing sponsors, to

"(II) the total annualized wages with respect to the active participants under such plans.

"(iii) CONTRIBUTION-INCOME RATIO.—The contribution-income ratio is the ratio of—

"(I) the total required contributions under all single-employer plans of which the persons who were contributing sponsors of the terminated plan or members of such sponsors' controlled groups (if any) were contributing sponsors, to

"(II) the consolidated gross income of such persons.

"(iv) RELEVANT PRECEDING PLAN YEAR.—The relevant preceding plan year is the later of—

"(I) the fifth plan year of the terminated plan preceding the termination date, or

"(II) the plan year of the terminated plan following the effective date of the most recent plan amendment increasing benefits adopted and taking effect before the termination date.

"(v) SPECIAL RULE IN CASES OF SUBSTANTIAL LAYOFFS.—The requirements of clause (i) shall be considered not to be met if 40 percent or more of the employees who were, as of the beginning of the relevant preceding plan year, participants in the plan are no longer participants in the plan, as of the termination date, by reason of dismissal from covered service under the plan.

"(3) SPECIAL RULE FOR CERTAIN TERMINATIONS INCIDENT TO SALE OF BUSINESS FOR FAIR VALUE TO UNRELATED PARTY.—The requirements of this paragraph are met if—

"(A) in the course of the termination, assets and liabilities of the terminated plan are transferred to any other plan (hereinafter in this paragraph referred to as the 'new plan') through the purchase of annuities,

"(B) the transfer occurred as part of a sale for fair value to an unrelated party (within the meaning of section 4204(d)) of all the assets of, or all the ownership interest in, all of the persons who were (as of immediately before the transfer) contributing sponsors of the terminated plan,

"(C) the corporation determines that such persons have ceased operations which were covered by the terminated plan and do not intend to resume such operations at any time during the 5-year period following the termination date, and

"(D) the liabilities under the new plan are structured so that—

"(i) each participant in the terminated plan (as of immediately before the termination) is a participant in the new plan (as of immediately after the termination), and the present value (as of immediately after the termination) of the liabilities of the new plan with respect to each such participant is not less than the present value (as of immediately before the termination) of the liabilities of the terminated plan with respect to such participant, or

"(ii) the requirements of clause (i) are not met—

"(I) only with respect to participants who are active participants in the terminated plan (as of immediately before the termination), and

"(II) only to the extent that the total present value of benefits with respect to active participants is reduced (on a pro rata basis with respect to each participant) by an amount by which the total present value of the benefits with respect to pay-status participants is increased by reason of a provision under the new plan, effective as of the termination date, under which all persons who were pay-status participants in the terminated plan (as of immediately before the termination) are pay-status participants in the new plan (as of immediately after the termination) and all benefits which are or become payable to pay-status participants in the new plan on or after the termination date are subsequently increased at an annual rate equal to the annual rate of increase in the Consumer Price Index (as prepared by the Department of Labor).

Compliance with subparagraph (D)(ii) shall not be construed to be a violation of section 208 or this Act or section 401(a)(12) of the Internal Revenue Code of 1954.

"(4) BUSINESS NECESSITY DETERMINATION PRECLUDED WHERE PRIMARY PURPOSE IS TO FINANCE CORPORATE TAKE-OVERS.—For purposes of this section, a termination of a plan shall not be considered a business necessity if a primary purpose of the termination is to make available to any person who is a contributing sponsor or a member of a contributing sponsor's controlled group funds to assist such person in preventing or promoting the entry into such person's controlled group of any other person.

"(5) BUSINESS NECESSITY DETERMINATION PRECLUDED FOR RECENTLY ESTABLISHED PLANS.—For purposes of this section, a termination of a plan shall not be considered a business necessity if the termination occurs before completion of the fifth plan year of the plan.

"(6) COORDINATION.—The corporation shall promptly notify the Secretary of the Treasury of any regulations prescribed or determination made pursuant to this subsection.

"(g) DEFINITIONS.—For purposes of this section:

"(1) CONTRIBUTING SPONSOR.—The term 'contributing sponsor' means a person, whether or not incorporated, who is responsible for meeting the funding requirements under section 302 of this Act or section 412 of the Internal Revenue Code of 1954.

"(2) CONTROLLED GROUP.—

"(A) IN GENERAL.—The term 'controlled group', in connection with any person, means a group consisting of such person and all other persons under common control with such person.

"(B) COMMON CONTROL.—The determination of whether two or more persons are under 'common control' shall be based on the principles which apply under section 4001(b) in the case of a multiemployer plan in determining whether employees of two or more trades or businesses (whether or not incorporated) are to be treated as employed by a single employer, except that 'common control' shall be based on a common interest of more than 50 percent.

"(3) SUBSTANTIAL MEMBER.—The term 'substantial member' of a controlled group means a person whose assets comprise 5 percent or more of the total assets of the controlled group as a whole. Such term includes any member of the controlled group referred to in subparagraph (A) or (B) of subsection (f)(2) who does not meet the requirements of the preceding sentence but did meet such requirements—

"(i) for purposes of such subparagraph (A), as of the beginning of the earliest applicable plan year referred to therein, or

"(ii) for purposes such subparagraph (B), as of the date of the filing of the petition referred to therein.

"(4) ACTIVE PARTICIPANT.—The term 'active participant' means, in connection with a plan, an active employee who is a participant in the plan and on whose behalf contributions are required to be made during the plan year.

"(5) PAY-STATUS PARTICIPANT.—The term 'pay-status participant' means, in connection with a plan, a participant in the plan with respect to whom retirement benefits have become payable.".

(b) CONFORMING AND CLERICAL AMENDMENTS.—

(1) The heading for section 4044 of such Act is amended to read as follows:

"ALLOCATION AND DISTRIBUTION OF PLAN ASSETS IN SINGLE-EMPLOYER PLAN TERMINATIONS".

(2) The item relating to section 4044 in the table of contents in section 1 of such Act is amended to read as follows:

"Sec. 4044. Allocation and distribution of plan assets in single-employer plan terminations.".

SEC. 5. NOTICE OF INTENT TO FILE FOR SINGLE-EMPLOYER PLAN TERMINATION.

(a) In General.—Section 4041(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1341(a)) is amended by inserting "and after 60 days advance written notice to the plan participants and their beneficiaries," before "the plan administrator" the first place it appears.

(b) Effective Date.—The amendment made by this section shall apply with respect to notices filed with the Pension Benefit Guaranty Corporation on or after the date of the enactment of this Act.

SEC. 6. EFFECT OF PLAN REVERSIONS TO EMPLOYERS ON ABILITY TO OBTAIN QUALIFICATION OF COMPARABLE PLANS, ON FUNDING REQUIREMENTS, AND ON ABILITY TO OBTAIN FUNDING WAIVERS AND AMORTIZATION EXTENSIONS.

(a) Five-year Disqualification Rule for Replacement Plans Where Plan Termination Is Not Business Necessity.—Subsection (a) of section 401 of the Internal Revenue Code of 1954 (relating to requirements for qualification) is amended by inserting after paragraph (24) the following new paragraph:

"(25) FIVE-YEAR DISQUALIFICATION RULE FOR REPLACEMENT PLANS WHERE PLAN TERMINATION IS NOT BUSINESS NECESSITY.—

"(A) GENERAL RULE.—In any case in which a single-employer plan terminates under section 4041 in a termination which is not a business necessity (determined in accordance with section 4044(f) of such Act), a trust forming a part of any plan which is a derivative plan or successor plan with respect to the terminated plan shall not constitute a qualified trust under this section.

"(B) EXCEPTION.—Subparagraph (A) shall not apply with respect to a plan which is a derivative plan or a successor plan with respect to the terminated plan if—

"(i) in the case of a derivative plan, the requirements of subparagraph (C) are met,

"(ii) in the case of a successor plan, the requirements of subparagraph (D) are met, and

"(iii) in either such case, no waiver of the minimum funding standard under section 412(d) is requested during the period of 5 plan years for which accelerated amortization is in effect pursuant to section 412(b)(8).

"(C) REQUIREMENTS FOR EXCEPTION OF DERIVATIVE PLANS.—The requirements of this subparagraph are met in the case of a derivative plan with respect to a terminated plan if—

"(i) such derivative plan retains the same benefit formula as that provided under such derivative plan as of immediately before the transfer described in subparagraph (E)(i) and is not amended to reduce the rate of benefit accrual under the plan at any time during the period of 5 plan years for which accelerated amortization is in effect pursuant to section 412(b)(8), and

"(ii) in any case in which any of the accrued benefits, under the plan from which the transfer occurred, of individuals who are participants or beneficiaries under such derivative plan are not funded by the purchase of annuity or guaranteed income contracts—

"(I) the accrued benefits, under the plan from which the transfer occurred, of each such individual which are not so funded are treated as accrued benefits of such individual under such derivative plan, "(II) the funding standard account under such derivative plan has been credited with an amount equal to the reasonably anticipated total amount of benefits payable under the derivative plan for the first plan year following the transfer, and

"(III) the rate at which the funding standard account under such derivative plan is credited pursuant to section 412(b)(3) is 125 percent of the rate for the plan year (of the plan from which such transfer occurred) preceding such transfer.

"(D) REQUIREMENTS FOR EXCEPTION OF SUCCESSOR PLANS.—The requirements of this subparagraph are met in the case of a successor plan with respect to a terminated plan if—

"(i) such successor plan provides for participation and benefit accrual so that benefits which would have been available on any date upon retirement under such terminated plan if such plan had not terminated would have been no greater than the benefits which are provided under such successor plan upon retirement on such date, and such provision remains in effect for at least the 5 plan years for which accelerated amortization is in effect pursuant to section 412(b)(8),

"(ii) the accrued benefits under such terminated plan of individuals who are covered under such successor plan are treated as accrued benefits under such successor plan, except that this subclause shall be applicable only if the employer has requested and obtained from the Secretary approval of, and implemented, a method of maintaining such successor plan's funding standard account under section 412 so as to provide for a future amortization period for the unfunded accrued benefits of such successor plan at the lesser of 30 years or the weighted average future remaining working lifetime of all participants in such successor plan, and

"(iii) the employer has requested and obtained from the Secretary approval of a funding method under such successor plan which provides, effective as of the termination date of the terminated plan, for combining and offsetting amortization bases in accordance with section 412(b)(4),

"(E) DEFINITIONS.—For purposes of this paragraph—

"(i) DERIVATIVE PLAN.—A plan is a derivative plan with respect to a terminated plan if—

"(I) within one year before the proposed date of termination specified in the notice of intent to terminate provided to the Pension Benefit Guaranty Corporation by the plan administrator of the terminated plan under section 4041(a) of the Employee Retirement Income Security Act of 1974, assets or liabilities were transferred to such plan from the terminated plan,

"(II) such plan is a comparable plan with respect to such other plan, and

"(III) such plan covers one or more participants who were covered under such other plan immediately before such transfer and provides benefits which are similar (within the meaning of regulations of the corporation) to the benefits provided under such other plan immediately before such transfer.

"(ii) SUCCESSOR PLAN.—A plan is a successor plan with respect to a terminated plan if—

"(I) such plan is established during the five-year period beginning on the termination date of the terminated plan,

"(II) such plan is a comparable plan with respect to the terminated plan, and

"(III) such plan covers one or more participants who were covered under the terminated plan immediately before its termination and provides benefits which are similar (within the meaning of regulations of the corporation) to the benefits provided under the terminated plan.

"(iii) COMPARABLE PLAN.—The plan is a comparable plan with respect to any other plan if—

"(I) in any case in which deductions with respect to one such plan are determined pursuant to paragraph (1) or (2) of section 404(a), deductions with respect to the other such plan are determined pursuant to either such paragraph, and

"(II) in any case in which deductions with respect to one such plan are determined pursuant to paragraph (3) of section 404(a), deductions with respect to the other such plan are determined pursuant to such paragraph.".

(b) LIMITATION ON AVAILABILITY OF FUNDING WAIVERS FOR REPLACEMENT PLANS AFTER EMPLOYER REVERSIONS.—

(1) AMENDMENT OF EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—Section 303 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1083) is amended—

(A) by redesignating subsection (d) as subsection (e); and

(B) by inserting after subsection (c) the following new subsection:

"(d)(1) Except as provided in paragraph (2), in any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D), no waiver shall be available under this section, with respect to any derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i) of the Internal Revenue Code of 1954) or any successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii) of such Code) established by the employer, for—

"(A) any plan year beginning on or within 10 years after the termination date of the terminated plan, and

"(B) any plan year within the period of 5 plan years for which accelerated amortization is in effect under the derivative plan or successor plan pursuant to section 302(d).

"(2) In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) where the termination is a business necessity (determined in accordance with section 4044(f)), no waiver shall be available under this section, with respect to any derivative plan or successor plan referred to in paragraph (1), for any plan year within the period described in paragraph (1)(B).".

(2) AMENDMENT OF INTERNAL REVENUE CODE OF 1954.—Subsection (d) of section 412 of the Internal Revenue Code of 1954 (relating to variance from

minimum funding standard) is amended by adding after paragraph (3) the following new paragraph:

"(4) LIMITATION ON AVAILABILITY OF FUNDING WAIVERS FOR REPLACEMENT PLANS AFTER EMPLOYER REVERSIONS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974, no waiver shall be available under this subsection, with respect to any derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i)) or any successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii)) established by the employer, for—

"(i) any plan year beginning on or within 10 years after the termination date of the terminated plan, and

"(ii) any plan year within the period of 5 plan years for which accelerated amortization is in effect under the derivative plan or successor plan pursuant to section 408(b)(8).

"(B) REVERSION WHERE TERMINATION IS BUSINESS NECESSITY.—In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974 where the termination is a business necessity (determined in accordance with section 4044(f) of such Act), no waiver shall be available under this subsection, with respect to any derivative plan or successor plan referred to in subparagraph (A), for any plan year within the period described in subparagraph (A)(ii).".

(c) LIMITATIONS ON AVAILABILITY OF EXTENSIONS OF AMORTIZATION PERIODS FOR COMPARABLE PLANS AFTER EMPLOYER REVERSIONS.—

(1) AMENDMENTS TO EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—Section 304 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1084) is amended—

(A) by redesignating subsection (b) as subsection (c); and

(B) by inserting after subsection (a) the following new subsection:

"(b)(1) Except as provided in paragraph (2), in any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D), no extension shall be available under this section, with respect to any derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i) of the Internal Revenue Code of 1954) or any successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii) of such Code) established by the employer, for—

"(A) any plan year beginning on or within 10 years after the termination date of the terminated plan, and

"(B) any plan year within the period of 5 plan years for which accelerated amortization is in effect under the derivative plan or successor plan pursuant to section 302(d).

"(2) In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) where the termination is a business necessity (determined in accordance with section 4044(f)), no extension shall be available under this section, with respect to any derivative plan or successor plan referred to in paragraph (1), for any plan year within the period described in paragraph (1)(B).".

(2) AMENDMENTS TO INTERNAL REVENUE CODE OF 1954.—Subsection (e) of section 412 of the Inter-

nal Revenue Code of 1954 (relating to extension of amortization periods) is amended—

(A) by redesignating subsection (b) as subsection (c); and

(B) by inserting after subsection (a) the following new subsection:

"(b) LIMITATION ON AVAILABILITY OF EXTENSIONS OF AMORTIZATION PERIODS FOR REPLACEMENT PLANS AFTER EMPLOYER REVERSIONS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), in any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974, no extension shall be available under this section, with respect to any derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i)) or any successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii)) established by the employer, for—

"(A) any plan year beginning on or within 10 years after the termination date of the terminated plan, and

"(B) any plan year within the period of 5 plan years for which accelerated amortization is in effect under the derivative plan or successor plan pursuant to section 408(b)(8).

"(2) REVERSION WHERE TERMINATION IS BUSINESS NECESSITY.—In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974 where the termination is a business necessity (determined in accordance with section 4044(f) of such Act), no extension shall be available under this section, with respect to any derivative plan or successor plan referred to in paragraph (1), for any plan year within the period described in paragraph (1)(B).".

(d) FASTER FUNDING REQUIRED FOR REPLACEMENT PLANS AFTER EMPLOYER REVERSIONS.—

(1) AMENDMENTS TO EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(A) GENERAL RULE.—Section 302 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082) is amended—

(i) by redesignating subsection (d) as subsection (e); and

(ii) by inserting after subsection (c) the following new subsection:

"(d) In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) and establishes a derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i) of the Internal Revenue Code of 1954) or a successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii) of such Code), subsections (b) and (c) shall be applied with respect to each of the 5 plan years of the derivative plan or successor plan ending after the termination date of the terminated plan by—

"(1) substituting '20 plan years' for '30 plan years' each place it appears therein, and

"(2) by substituting '10 plan years' for '15 plan years' each place it appears therein.".

(B) ALTERNATIVE MINIMUM FUNDING STANDARD NOT AVAILABLE.—Subsection (a) of section 305 of such Act (29 U.S.C. 1085(a)) is amended by adding at the end thereof the following new sentence: "This section shall not apply with respect to any plan while the plan is subject to the funding requirements of section 302(d).".

(2) AMENDMENTS TO INTERNAL REVENUE CODE OF 1954.—

(A) GENERAL RULE.—Subsection (b) of section 412 of the Internal Revenue Code of 1954 (relating to funding standard account) is amended by inserting after paragraph (7) the following new paragraph:

"(8) FASTER FUNDING REQUIRED FOR REPLACEMENT PLANS AFTER EMPLOYER REVERSIONS.—In any case in which an employer accepts payment of residual assets of a terminated plan pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974 and establishes a derivative plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(i)) or a successor plan with respect to the terminated plan (within the meaning of section 401(a)(26)(E)(ii)), paragraphs (2) and (3) shall be applied with respect to each of the 5 plan years of the derivative plan or successor plan ending after the termination date of the terminated plan by—

"(A) substituting '20 plan years' for '30 plan years' each place it appears therein, and

"(B) by substituting '10 plan years' for '15 plan years' each place it appears therein.".

(B) ALTERNATIVE MINIMUM FUNDING STANDARD NOT AVAILABLE.—Paragraph (1) of section 412(g) of such Code (relating to alternative minimum funding standard) is amended by adding at the end thereof the following new sentence: "This subsection shall not apply with respect to any plan while the plan is subject to the funding requirements of subsection (b)(8).".

SEC. 7. EXCISE TAX ON REVERSIONS TO EMPLOYERS UPON TERMINATION OF SINGLE-EMPLOYER PLANS.

(a) In General.—Chapter 43 of the Internal Revenue Code of 1954 (relating to excise taxes in connection with qualified pension, etc., plans) is amended by adding at the end thereof the following new section:

"SEC. 4976. EXCISE TAX ON REVERSIONS TO EMPLOYERS UPON TERMINATION OF SINGLE-EMPLOYER PLANS.

"(a) Tax Imposed.—A tax is hereby imposed on any distribution to an employer, pursuant to section 4044(d)(1)(D) of the Employee Retirement Income Security Act of 1974, of residual assets of a plan terminated under section 4041 of such Act.

"(b) Amount of Tax.—The amount of the tax imposed by subsection (a) is 10 percent of the fair market value of the residual assets so distributed.

"(c) Employer Liable.—The tax imposed by this section shall be paid by the employer.".

(b) Conforming Amendment.—The table of sections for chapter 43 of such Code is amended by adding at the end thereof the following new item:

"Sec. 4976. Excise tax on reversions to employers upon termination of certain plans.".

SEC. 8. REQUIREMENTS RELATING TO EMPLOYER SECURITIES ACQUIRED OR HELD BY PLANS.

(a) EMPLOYER SECURITIES LIMITED TO STOCK IN THE EMPLOYER AND TO 5 PERCENT OF PLAN ASSETS.—Section 407 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1107) is amended by striking out all that precedes subsection (d) and inserting in lieu thereof the following:

"PERCENT LIMITATIONS WITH RESPECT TO ACQUISITION AND HOLDING OF EMPLOYER SECURITIES AND EMPLOYER REAL PROPERTY BY CERTAIN PLANS

"SEC. 407. (a)(1) A plan may not acquire (as an employer contribution or otherwise)—

"(A) any employer security which is not qualifying employer stock, or

"(B) any qualifying employer stock if immediately after such acquisition the aggregate fair market value of employer securities held by the plan exceeds 5 percent of the fair market value of the assets of the plan.

"(2) A plan may not acquire (as an employer contribution or otherwise)—

"(A) any employer real property which is not qualifying employer real property, or

"(B) any qualifying employer real property if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

"(b)(1)(A) After December 31, 1985, a plan may not hold—

"(i) any employer security which is not a qualifying employer security, or

"(ii) any qualifying employer security to the extent that the aggregate fair market value of employer securities held by the plan as of December 31, 1985, exceeds 10 percent of the greater of—

"(I) the fair market value of the assets of the plan, as of December 31, 1985, or

"(II) the fair market value of the assets of the plan determined on January 1, 1975.

"(B) After December 31, 1990, a plan may not hold—

"(i) any employer security which is not qualifying employer stock, or

"(ii) any qualifying employer stock to the extent that the aggregate fair market value of employer securities held by the plan as of December 31, 1990, exceeds 5 percent of the greater of—

"(I) the fair market value of the assets of the plan, as of December 31, 1990, or

"(II) the fair market value of the assets of the plan determined on January 1, 1980.

"(2) After December 31, 1985, a plan may not hold—

"(A) any employer real property which is not qualifying employer real property, or

"(B) any qualifying employer real property to the extent that the aggregate fair market value of such property and any employer securities held by the plan, as of December 31, 1985, exceeds 10 percent of the greater of—

"(i) the fair market value of the assets of the plan, as of December 31, 1985, or

"(ii) the fair market value of the assets of the plan determined on January 1, 1975.

"(3) The Secretary shall prescribe by regulation appropriate means of determining fair market value for purposes of this subsection.

"(4)(A) After June 30, 1988, a plan may not hold any employer securities in excess of the amount specified in regulations under subparagraph (B). This subparagraph shall not apply to a plan after the earliest date after December 31, 1985, on which it complies with such regulations.

"(B) Not later than December 31, 1986, the Secretary shall prescribe regulations which shall have the effect of requiring that a plan divest itself of 50 percent of the holdings of employer securities and employer real property which the plan would be required to divest before January 1, 1991, under paragraph (1)(B).

"(c)(1) Subsection (b) shall not apply to any acquisition or holding of qualifying employer securities, qualifying employer stock, or qualifying employer real property by an eligible individual account plan.

"(2) Paragraphs (1)(A)(ii), (1)(B)(ii), and (2)(B) of subsection (b) shall apply to any plan only if, on any date after December 31, 1974, and before January 1, 1986, the plan held employer securities or employer real property (or both) the aggregate fair market value of which, as of such date, exceeded 10 percent of the greater of—

"(A) the fair market value of the assets of the plan, as of such date, or

"(B) the fair market value of the assets of the plan, as of January 1, 1975.

"(3) A plan which made, on or before December 31, 1975, the election under paragraph (3) of subsection (c) of this section (as in effect before January 1, 1986) shall be treated as satisfying the requirements of paragraphs (1)(A)(ii), (1)(B)(ii), and (2)(B) of subsection (b) if and only if the requirements of such subsection (c) are met with respect to employer securities held by the plan.".

(b) QUALIFYING EMPLOYER STOCK.—Subsection (d) of section 407 of such Act is amended—

(1) by redesignating paragraphs (6), (7), and (8) as paragraphs (7), (8), and (9), respectively; and

(2) by inserting after paragraph (5) the following new paragraph:

"(6) The term 'qualifying employer stock' means an employer security which—

"(A) is stock in the employer,

"(B) does not constitute, and is not acquired subject to, any bond, debenture, note, or certificate or other evidence of indebtedness, and

"(C) is not subject to any restriction on marketability or voting power applicable by reason of its acquisition by a plan.".

(c) CONFORMING AMENDMENTS.—

(1) Subsection (e) of section 407 of such Act is amended to read as follows:

"(e) CROSS REFERENCES.—

"(1) For exemption from diversification requirements for holding of qualifying employer securities, qualifying employer stock, and qualifying employer real property by eligible individual account plans, see section 404(a)(2).

"(2) For exemption from prohibited transactions for certain acquisition of qualifying employer securities, qualifying employer stock, and qualifying employer real property which are not in violation of percent limitations, see section 408(e).

"(3) For transitional rules respecting securities or real property subject to binding contracts in effect on June 30, 1974, see section 414(c).".

(2) Paragraph (2) of section 404(a)(2) of such Act (29 U.S.C. 1104(a)(2)) is amended by striking out "qualifying employer real property or qualifying employer securities (as defined in section 407(d) (4) and (5))" and inserting in lieu thereof "qualifying employer real property, qualifying employer securities, or qualifying employer stock (as defined in section 407(d) (4), (5), and (6))".

(3) Subsection (e) of section 408 of such Act (29 U.S.C. 1108(e)) is amended—

(A) by inserting "or qualifying employer stock (as defined in section 407(d)(6))" after "qualifying employer securities (as defined in section 407(d)(5))";

(B) in paragraph (1), by striking out "(or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 407(e)(1))"; and

(C) in paragraph (3)(B), by inserting "qualifying employer stock" after "qualifying employer securities".

(4) Section 414(c) of such Act (29 U.S.C. 1114) is amended—

(A) by striking out "407(a)" the first place it appears and inserting in lieu thereof "407 (a) and (b)"; and

(B) by striking out "407(a)" in paragraph (5) and inserting in lieu thereof "407(b)".

(5) The table of contents in section 1 of such Act is amended by striking out "10 percent limitation" and inserting in lieu thereof "Percent limitations".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect January 1, 1986, and shall apply with respect to employer securities and employer real property held or acquired on or after such date.

SEC. 9. PRESCRIPTION BY JOINT BOARD FOR THE ENROLLMENT OF ACTUARIES OF REASONABLE ACTUARIAL ASSUMPTIONS AND METHODS.

(a) AUTHORITY TO PRESCRIBE REASONABLE ACTUARIAL ASSUMPTIONS AND METHODS.—Subtitle C of title III of the Employee Retirement Income Security Act of 1974 is amended—

(1) by redesignating section 3043 as section 3044; and

(2) by inserting after section 3042 the following new section:

"PRESCRIPTION BY JOINT BOARD OF REASONABLE ACTUARIAL ASSUMPTIONS AND METHODS

"SEC. 3043. (a)(1) The Joint Board shall, as soon as practicable after the date of the enactment of the Plan Termination and Reversion Control Act of 1985, conduct a thorough study relating to the reasonable actuarial assumptions and methods, for each of the various types of pension plans, which are appropriate for use by enrolled actuaries and others under this Act and the Internal Revenue Code of 1954 in determining the actuarial status and funding requirements of such plans.

"(2) Not later than 2 years after such date, the Joint Board shall—

"(A) complete such study and submit a report on such study to the Committee on Education and Labor, the Committee on Ways and Means, and the Select Committee on Aging of the House of Representatives and the Committee on Labor and Human Resources, the Committee on Finance, and the Special Committee on Aging of the Senate, setting forth the results of its study, together with any legislative recommendations,

"(B) prescribe by regulation appropriate procedures for determining, for each type of plan, the appropriate actuarial assumptions and methods referred to in paragraph (1), and

"(C) determine such actuarial assumptions and methods for each type of pension plan in accordance with such procedures and publish such assumptions and methods in the Federal Register.

"(b) From time to time as the Joint Board considers appropriate after the initial publication of reasonable actuarial assumptions and methods pursuant to subsection (a), the Joint Board may—

"(1) revise by regulation the procedures prescribed pursuant to this section, and

"(2) publish revised reasonable actuarial assumptions and methods for each type of plan (whether or not necessitated by a revision pursuant to paragraph (1)).".

(b) TERMINATION OF ENROLLMENT OF ENROLLED ACTUARIES ON FAILURE TO USE PRESCRIBED ASSUMPTIONS AND METHODS.—Subsection (b) of section 3042 of such Act (29 U.S.C. 1242(b)) is amended—

(1) by redesignating paragraph (2) as paragraph (3); and

(2) by striking out paragraph (1) and inserting in lieu thereof the following new paragraphs:

"(1) has failed to utilize the actuarial assumptions and methods prescribed by the Joint Board pursuant to section 3043, "(2) has otherwise failed to discharge such individual's duties under this Act, or".

(c) CONFORMING AMENDMENTS.—

(1) REQUIREMENTS UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(A) Paragraph (6) of section 103(d) of such Act (29 U.S.C. 1023(d)(6)) is amended by adding at the end thereof the following new sentence: "Such regulations shall be consistent with the actuarial assumptions and methods prescribed under section 3043.".

(B) Subsection (c) of section 302 of such Act (29 U.S.C. 1082(c)) is amended—

(i) in paragraph (2)(A), by striking out "any reasonable actuarial method" and inserting in lieu thereof "the actuarial method prescribed under section 3043"; and

(ii) in paragraph (3), by striking out "which" and all that follows down through "under the plan" and inserting in lieu thereof the following: "prescribed under section 3043".

(C) Subsection (a) of section 4213 of such Act (29 U.S.C. 1393(a)) is amended—

(i) by inserting after the first sentence the following new sentence: "In any case in which such assumptions differ from the applicable assumptions prescribed under section 3043, such regulations shall set forth the reasons for such difference.";

(ii) by striking out paragraph (1) and redesignating paragraph (2) as paragraph (1);

(iii) in paragraph (1) (as redesignated), by striking out "liability." and inserting in lieu thereof "liability, or"; and

(iv) by inserting after paragraph (1) (as redesignated) the following new paragraph:

"(2) if actuarial assumptions and methods are not set forth in the corporation's regulations pursuant to paragraph (1), actuarial assumptions and methods prescribed under section 3043.".

(D) Clause (i) of section 4221(a)(3)(B) of such Act (29 U.S.C. 1401(a)(3)(B)(i)) is amended to read as follows:

"(i) the actuarial assumptions and methods utilized in the determination were not those prescribed under section 3043, or".

(2) REQUIREMENTS UNDER THE INTERNAL REVENUE CODE OF 1954.—Subsection (c) of section 412

of the Internal Revenue Code of 1954 (relating to special rules for minimum funding standards) is amended—

(A) in paragraph (2)(A), by striking out "any reasonable actuarial method" and inserting in lieu thereof "the actuarial method prescribed under section 3043 of the Employee Retirement Income Security Act of 1974"; and

(B) in paragraph (3), by striking out "which" and all that follows down through "under the plan" and inserting in lieu thereof the following: "prescribed under section 3043 of the Employee Retirement Income Security Act of 1974".

(3) CLERICAL AMENDMENT.—The table of contents in section 1 of the Employee Retirement Income Security Act of 1974 is amended by striking out the item relating to section 3043 and inserting in lieu thereof the following new items:

"Sec. 3043. Prescription by Joint Board of reasonable actuarial assumptions and methods.
"Sec. 3044. Amendment of the Internal Revenue Code.".

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (c)(3) shall take effect on the date of the enactment of this Act. The amendments made by subsection (b) and paragraphs (1) and (2) of subsection (c) shall take effect on the first effective date of the actuarial assumptions and methods published by the Joint Board for the Enrollment of Actuaries in the Federal Register pursuant to section 3043(a)(2)(C) of the Employee Retirement Income Security Act of 1974 (as amended by this section).

SEC. 10. VOTING RIGHTS OF PARTICIPANTS IN EMPLOYEE STOCK OWNERSHIP PLANS TO WHICH ASSETS ARE TRANSFERRED UPON PLAN TERMINATION.

(a) TAX QUALIFICATION REQUIREMENTS.—

(1) IN GENERAL.—Subsection (a) of section 401 of the Internal Revenue Code of 1954 (relating to requirements for qualification) (as amended by section 6) is further amended by inserting after paragraph (25) the following new paragraph:

"(26) REQUIREMENTS RELATING TO VOTING RIGHTS OF PARTICIPANTS UNDER EMPLOYEE STOCK OWNERSHIP PLANS UPON TRANSFERS OF ASSETS FROM TERMINATED PLANS.—

"(A) GENERAL RULE.—In any case in which assets are transferred to an employee stock ownership plan in a termination of a defined benefit plan under subtitle C of title IV of the Employee Retirement Income Security Act of 1974, a trust forming a part of the employee stock ownership plan shall constitute a qualified trust under this section only if—

"(i) the transfer is approved in advance in writing by a majority of the participants in the terminated plan,

"(ii) the assets of the terminated plan which are allocated to each participant commencing participation in the employee stock ownership plan in connection with such transfer and which are transferred to the employee stock ownership plan are deposited immediately to an account under the employee stock ownership plan for such participant, and

"(iii) the voting ratio under the employee stock ownership plan of each participant who commenced participation in the plan in connection with the transfer is not less than the participant's asset ratio under the plan.

"(B) VOTING RATIO.—For purposes of this paragraph, a participant's voting ratio under the employee stock ownership plan referred to in subparagraph (A) is the ratio of—

"(i) the total combined voting power of all classes of stock under the plan which are entitled to be voted by the participant, to "(ii) the total combined voting power of all classes of stock under the plan which are entitled to be voted by all participants under the plan.

"(C) ASSET RATIO.—For purposes of this paragraph, a participant's asset ratio under the employee stock ownership plan referred to in subparagraph (A) is the ratio of—

"(i) the lesser of—

"(I) the fair market value (as of the date of the transfer of assets to the plan) of the assets required to be allocated to such participant under section 4044 of the Employee Retirement Income Security Act of 1974 in connection with the termination of the terminated plan referred to in subparagraph (A), or

"(II) the fair market value (as of such date) of the assets of the terminated plan which are actually transferred to the employee stock ownership plan to the account of the participant,

to

"(ii) the fair market value (as of such date) of all assets of the employee stock ownership plan (including all assets transferred from the terminated plan).

"(D) EMPLOYEE STOCK OWNERSHIP PLAN.—For purposes of this paragraph, the term 'employee stock ownership plan' means a plan described in section 4975(e)(7), determined without regard to the plan's qualification status under this paragraph.".

(2) CONFORMING AMENDMENT.—Section 401(a) of such Code is further amended, in the last sentence, by striking out "and (20)" and inserting in lieu thereof "(20), and (25)".

(b) PROHIBITED TRANSACTION RULES APPLICABLE IRRESPECTIVE OF TAX QUALIFICATION STATUS.—Subsection (a) of section 406 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1106(a)) is amended by adding after paragraph (2) the following new paragraph:

"(3)(A) No fiduciary who has authority or discretion to control or manage the assets of a plan may, in a termination of the plan under subtitle C of title IV, permit the plan to transfer assets to an employee stock ownership plan unless—

"(i) the transfer is approved in advance in writing by a majority of the participants in the terminated plan,

"(ii) the assets of the terminated plan which are allocated to each participant commencing participation in the employee stock ownership plan in connection with such transfer and which are transferred to the employee stock ownership plan are transferred immediately to an account under the employee stock ownership plan for such participant, and

"(iii) the voting ratio under the employee stock ownership plan of each participant who commenced participation in the plan in connection with the transfer is not less than the participant's asset ratio under the plan.

"(B) For purposes of this paragraph—

"(i) a participant's voting ratio under the employee stock ownership plan referred to in subparagraph (A) is the ratio of—

"(I) the total combined voting power of all classes of stock under the plan which are entitled to be voted by the participant, to

"(II) the total combined voting power of all classes of stock under the plan which are entitled to be voted by all participants;

"(ii) a participant's asset ratio under the terminated plan referred to in subparagraph (A) is the ratio of the lesser of—

"(I) the fair market value (as of the date of the transfer of assets to the plan) of the assets required to be allocated to such participant under section 4044 in connection with the termination of the terminated plan referred to in subparagraph (A), or

"(II) the fair market value (as of such date) of the assets of the terminated plan which are actually transferred to the employee stock ownership plan to the account of the participant,

to the fair market value (as of such date) of all assets of the employee stock ownership plan (including all assets transferred from the terminated plan); and

"(iii) the term 'employee stock ownership plan' means a plan described in section 4975(e)(7) of the Internal Revenue Code of 1954, determined without regard to the plan's qualification status under section 401(a)(25) of such Code.".

SEC. 11. EFFECTIVE DATE; CONSTRUCTIVE DATE OF FILING OF NOTICES OF PLAN TERMINATIONS.

(a) Effective Date.—Except as otherwise provided in this Act, the amendments made by this Act shall apply to pension plan terminations with respect to which notices are filed with the Pension Benefit Guaranty Corporation pursuant to section 4041(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1341(a)) on or after January 1, 1984.

(b) Constructive Date of Filing of Notices of Plan Terminations.—For purposes of the amendments made by this Act, except the amendment made by section 5, any such notice filed before the date of the enactment of this Act shall be treated as filed on such date of enactment.

APPENDIX V

BUCK
CONSULTANTS
1050 Seventeenth Street, NW
Washington, D.C. 20036   202 | 296-7264

July 8, 1985

The Honorable Edward R. Roybal
Chairman
Select Committee on Aging
712 House Office Building, Annex I
U.S. House of Representatives
Washington, D.C. 20515

Re: H.R. 2701

Dear Mr. Roybal:

At the joint hearing on June 12 you requested me to submit comments on H.R. 2701. I have completed my review of the bill and submit my comments. I request that they be included with the record of the hearing.

I commend you for the leadership you have taken in addressing this important issue. Though I differ with your proposed solution, I have the highest respect for your commitment to solving the problem.

Yours sincerely,

Donald S. Grubbs, Jr., F.S.A.
Consulting Actuary

DSG:bmj

cc: The Honorable William Clay
Chairman
Subcommittee on Labor Management
Relations
2451 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Buck Consultants, Inc.
George B. Buck Consulting Actuaries, Inc | Buck Pension Fund Services, Inc. | Buck Research Corporation | GBB Associates, Ltd.

COMMENTS ON H.R. 2701
PLAN TERMINATION AND REVERSION CONTROL ACT OF 1985

BY
DONALD S. GRUBBS, JR., F.S.A.
CONSULTING ACTUARY
BUCK CONSULTANTS, INC.

PRESENTED FOR THE RECORD OF THE JOINT HEARING OF
THE SELECT COMMITTEE ON AGING AND
THE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

JULY 8, 1985

In response to the request of Congressman Roybal at the hearing, I hereby submit my comments and analysis of H.R.2701. The viewpoints presented are solely those of the author.

I commend Congressman Roybal for focusing the attention of Congress on the serious problems of termination of pension plans. I highly respect his commitment to solving those problems. I differ regarding the best solution.

I concur that the 10% excise tax in Section 7 of the bill would help deter plan terminations and would be beneficial.

I concur that minimum funding requirements need strengthening (section 6(c)), but believe that such strengthening is needed for all plans, not just replacement plans.

I concur that modification is needed in the definition of qualifying employer securities (section 8), but differ concerning the exact change.

I concur that changes are needed in the control of stock held by ESOPs, regardless of whether it is related to a terminated plan, but suggest a differing approach.

The general thrust of the bill in severely limiting reversions would, in my opinion, discourage employers from establishing defined benefit plans or from soundly funding them. Instead we need an approach which encourages employers to continue establishing and maintaining defined benefit plans funded on a sound basis.

My detailed comments follow.

Section 2

Section 2 would amend both section 208 of ERISA and section 414(l) of the Internal Revenue Code to state that mergers and transfers may not violate ERISA section 403(c)(1). Since plans are presently forbidden to violate section 403(c)(1) in any respect, this would add superfluous language with no effect at all.

Section 3

Section 3(a) and (b) would add new enforcement provisions in case of a violation of ERISA section 4044(d) or Code section 401(1(25)(B). I have not heard of any allegation that existing sanctions for such violations is inadequate. This adds a little more verbiage and complexity to the law, always a disadvantage.

Section 3(c) would add sanctions against an individual who takes "any action with the intent to exert undue influence.....if a purpose" is to protect his position by stopping a takeover or similar situation. "Intent", "undue influence" and "purpose" are so vague as to ensure extensive litigation, primarily benefiting lawyers. Rules should be as clearcut as possible, both because individuals should be able to tell whether they are violating the rules and because otherwise enforcement is difficult.

Section 3(d) would give PBGC the right to sue for relief under section 409 for certain violations under Title I. The Secretary of Labor now has this power to sue for relief under section 409. I know no reason to divide this power, or to think it would be better handled by PBGC.

Section 4

Section 4 would require that any excess assets on a plan termination be used to increase benefits in a specified manner, unless the termination is the result of "business necessity" as defined in the section. This section would add new complexity to ERISA. In my opinion it would tend to discourage employers from establishing defined benefit plans, and would encourage them to fund defined benefit plans on a minimal basis rather than a strong basis. It would reduce terminations with reversions, but in my judgement this benefit would be outweighed by the harm.

Section 5

Section 5 would amend ERISA section 4041(a) to require the employer to provide 60 days advance notice to participants before filing its advance notice of intent to terminate with PBGC.

If, as is usually the case, there is a simultaneous request for an IRS determination, the employee already receives notice of that request. Nevertheless it would be appropriate to notify employees of the intent to terminate. But notification any time before or simultaneous with filing the notice with PBGC would be adequate for all purposes. Adding two months to a process that already takes too long would serve no useful purpose.

Section 6

Section 6(a) would inhibit employers' ability to establish a new defined benefit plan after a plan termination. This would have the very undesirable effect of pushing employers to establish defined contribution plans instead of defined benefit plans.

Section 6(b) would severely restrict funding waivers under replacement plans. Since funding waivers are only allowed to be granted if it would hurt employers not to grant it (e.g. cause the second plan to terminate), this provision could only hurt participants.

Section 6(c) would modify the provisions related to extensions of amortization periods. This added complexity would have no practical effect whatsoever. To the best of my knowledge in the eleven years since ERISA was enacted there has not been a single request to extend amortization periods. In addition to recommending against enlarging this provision, I recommend that ERISA and the Code be amended to eliminate the present unused provision, taking one small step towards making the law simpler and shorter.

Section 6(d) would strengthen the minimum funding requirements for replacement plans by shortening the amortization periods and by eliminating the alternative minimum funding requirement. There is no apparent reason to have differing funding requirements for replacement plans. Strengthening the minimum funding requirements is needed for all plans.

Section 7

Section 7 would impose a 10% excise tax on reversions under terminated plans. Such a tax is also part of the President's Tax Proposals. This proposal would tend to discourage plan terminations to obtain reversions. It would also help recover part of the tax saving the employer had gained through deferral of taxable income. I support this provision.

Section 8

Section 8 would lower the limit on qualifying employer securities and qualifying employer real property held by pension plans from 10% to 5%, with a phase-in period. In my opinion this change would add a little more complexity to the law with no significant increase in the security of benefits.

Section 8 would also narrow the types of employer securities that can be contributed to or held by plans. Employer securities would be limited to unrestricted common stock. Eliminating employer stock with restrictions on marketability and voting rights is in the interest of participants. Eliminating contributions of marketable fixed dollar employer securities, on the other hand, could have the adverse affect of causing a cash-short employer to contribute less to the plan or to seek a funding waiver instead. I recommend replacing Section 7 with a simple amendment to ERISA section 407(d)(5), eliminating from the definition of qualifying employer security after 1990 any employer security subject to restrictions on marketability or voting rights.

Section 9

Section 9 would direct the Joint Board for the Enrollment of Actuaries to publish regulations on appropriate actuarial assumptions and methods.

Determining the reasonableness of actuarial methods and assumptions is currently the responsibility of the Internal Revenue Service. The proposal would have the effect of dividing this responsibility between IRS and the Joint Board, with overlapping roles. I previously served simultaneously as Director of the Actuarial Division of IRS and as Chairman of the Joint Board for the Enrollment of Actuaries. In my opinion it would be a serious mistake to attempt to partially transfer jurisdiction for part or all of this matter to the Joint Board. The IRS is better prepared to deal with the matter, and to coordinate the regulations with their implementation.

Any attempt to set specific rules for actuarial assumptions is full of pitfalls, as has been clearly shown by the mathematical demonstration that the IRS audit guidelines on the subject are absurd.

Section 10

Section 10(a) attempts to correct certain abuses in connection with transfer of excess assets under a terminated pension plan to an ESOP. However, requiring participant approval for a transfer of excess assets to an ESOP after all of their liabilities have been satisfied is not justified. And the problems of control of stock in an ESOP are not really different merely because the stock came from a terminated plan. Change is needed to correct abuse, regardless of whether ESOP securities come from a terminated plan. The ESOP distribution requirements of the President's tax proposals, coupled with an equitable allocation of voting rights with respect to any unallocated stock, could solve the problem for all ESOPs.

APPWP
Association of Private Pension and Welfare Plans

Stuart J. Brahs
Executive Director

July 25, 1985

The Honorable Edward R. Roybal
Chairman, Select Committee on Aging
712 House Annex No. 1
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your request that the Association of Private Pension and Welfare Plans (APPWP) analyze the provisions of the Plan Termination and Reversion Control Act of 1985 (H.R. 2701) and submit our comments to the Committee, as a follow-up to the testimony of David G. Marshall, Nabisco Brands, Inc. on January 12, 1985.

As we testified before the joint hearings of your Committee and the Subcommittee on Labor-Management Relations, the APPWP is increasingly concerned that any approach to the issue of defined benefit plan termination must carefully consider the long term effects on the willingness of employers to establish and maintain these valuable plans. As we have pointed out before, defined benefit plans provide the most reliable and secure benefits to employees, at the greatest financial risk to employers. Penalty taxes, hardship tests for termination, and inability to recover assets which far exceed the pension promises employers have made can only serve to discourage employers from providing these plans at all. Indeed, in the face of some of the legislative proposals in this area, we find it remarkable that employers are still willing to establish defined benefit plans initially, or to reestablish successor plans after termination. While we can only speculate on the effect of these proposals on the long term funding of these plans, it would not appear unlikely that employers have already and will continue to demand that the funding assumptions used prevent as completely as possible the build-up of any surplus in their pension plans. Are employees well-served by this result?

Thus we ask again, as we did at your recent hearing, and those that preceded it: what problem are we trying to address? If employees have an expectation that the plan which covers them will never be terminated, we would suggest that neither the plan terms nor the summary plan descriptions which they have received can possibly be read to support this expectation. If employees have an expectation that fortuitous surplus funds will irrevocably belong to them, we would suggest that they have overlooked the explicit benefit promise contained in those plans and plan descriptions.

One can as easily aruge that the legislative proposals now being considered have missed the real problem: That defined benefit plans are being terminated largely because termination is the only way an employer can have access to large surpluses. There are those who believe that this issue, if rationally addressed by rules that would permit an employer to withdraw substantial excess assets without terminating the plan, would, in fact, result in far fewer terminations in the future.

While we can understand and appreciate the sincerity of the views which underly the legislation, we cannot state strongly enough our belief that current law permitting reversion of surplus assets is the product of a careful balancing of equities reached after the 10 years of study which lead to the passage of ERISA, and should not be rejected in the face of a few short years of favorable asset performance.

Accordingly, we suggest that this proposed legislation is unnecessary and harmful to the private pension system, with ramifications that will make the cure far worse than the perceived ill. We thank you for the opportunity to present our views, and hope you will carefully consider them as you review this issue.

Sincerely,

Stuart J. Brahs

Stuart J. Brahs
Executive Director

SJB:sr

cc: Honorable William L. Clay

APPENDIX VI

[Information provided by Mr. David Walker, at the request of Mr. Saxton]

Nov-23-85 11:36 PAGE: 1

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME1	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
1)	INDUSTRIAL TOWEL AND UN CO	5/31/80	485	1974908	910542	1,064,366	1
2)	STP CORPORATION	7/31/80	246	2191632	1160493	1,031,139	7
3)	VALLEY NITROGEN PRDUCERS INC	9/30/80	839	2880000	1620000	1,260,000	1
4)	DURA CONTAINERS, INC	11/21/80	177	2088047	895104	1,192,943	1
5)	BUCKEYE INTERNATIONAL, INC	11/27/80	715	7550660	4687702	2,862,958	2
6)	WHITAKER CABLE CORPORATION	11/30/80	581	4966102	3365897	1,600,205	6
7)	CHAP STICK CO	12/14/80	377	3548803	2406624	1,142,179	10
8)	SHARON STEEL CORPORATION	12/15/80	554	10770350	8770677	1,999,673	3
9)	HOSPITAL CORPORATION OF	12/31/80	10268	22477057	16313028	6,164,029	10
10)	CANTON CO. OF BALTIMORE	3/01/81	164	3514853	1955825	1,559,028	19
11)	BULLETIN CO	3/02/81	1369	24055000	17517000	6,538,000	19
12)	IBEC.	3/26/81	107	3778925	1655682	2,123,243	10
13)	EMERSON ELECTRIC CO	3/31/81	284	3747151	1562702	2,184,449	4
14)	ZIFF-DAVIS PUBLISHING CO	4/23/81	2338	8400000	4300000	4,100,000	19
15)	OKC CORP	5/12/81	78	2498890	917671	1,581,219	3
16)	SHELLER-GLOBE CORP	5/12/81	1413	12275317	10360437	1,914,880	4
17)	AIR CALIFORNIA	5/12/81	901	2034595	956329	1,078,266	1
18)	BETHLEHEM GLOBE PUBLISHING CO	5/15/81	206	2327790	635036	1,692,754	15
19)	QUAKER STATE COCA COLA BTTLG	5/15/81	174	2706246	1272885	1,433,361	17
20)	CLEVELAND COCA COLA BTTLG CO	5/15/81	77	1639082	593827	1,045,255	15
21)	M W KELLOGG CO	6/11/81	9746	122799000	64800000	57,999,000	18
22)	MONTGOMERY ROSS FISHER INC	6/11/81	25	2425881	494465	1,931,416	18
23)	LONE STAR BUILDING CENTERS	6/30/81	60	3067536	1303054	1,764,482	1
24)	COOK PAINT AND VARNISH CO	7/01/81	764	5479676	2004580	3,475,096	15
25)	C H STUART INC	8/03/81	672	6949516	4467918	2,481,598	16
26)	HARPER & ROW PUBLISHERS INC	8/31/81	2101	16889000	6700000	10,189,000	18
27)	UNION PLANTERS NATIONAL BANK	8/31/81	1203	9863021	5719620	4,143,401	15
28)	OMNI SPECTRA, INC	9/03/81	216	1527583	477231	1,050,352	18
29)	SHEDD-BROWN, INC	9/28/81	92	1791465	718356	1,073,109	5
30)	KAHN & FELDMAN, INC	10/30/81	575	3102776	1394524	1,708,252	7
31)	CHEMETRON CORP	10/31/81	308	8356203	4998800	3,357,403	6
32)	CHEMETRON CORP	10/31/81	874	8063829	5889100	2,174,729	19
33)	CHEMETRON CORP	10/31/81	1247	10347594	7700100	2,647,494	6
34)	THE WASHINGTON STAR CO	11/09/81	964	14865629	9937400	4,928,229	4
35)	MERCHANTS REFRIGERATING CO	11/30/81	253	4105303	2192507	1,912,796	1
36)	COMMONWEALTH OIL REFINING CO	12/15/81	742	7267000	5238562	2,028,438	5
37)	OGDEN FOOD SERVICE CORP	12/26/81	210	3919033	2810033	1,109,000	18
38)	BANK OF THE COMMONWEALTH	12/28/81	1278	16500000	4510099	11,989,901	18
39)	SUTHERLAND LUMBER CO	12/31/81	594	6451696	3235193	3,216,503	6
40)	VANSANT, DUGDALE & CO, INC	12/31/81	72	2678726	579539	2,099,187	7
41)	EQUITABLE GENERAL INSURANCE	12/31/81	728	6799060	2325731	4,473,329	1
42)	ROBERT DOLLAR CO	12/31/81	179	3016500	1390001	1,626,499	3
43)	WINSTON-SALEM SAVINGS & LOAN	12/31/81	50	4355176	420811	3,934,365	1
44)	PRUDENTIAL LINES, INC	1/01/82	82	2564631	1284382	1,280,249	5
45)	GORDONS TRANSPORTS, INC	1/04/82	179	2200630	453027	1,747,603	18
46)	TRIANGLE PWC, INC	1/04/82	331	5575000	3657761	1,917,239	4
47)	CHARMING SHOPPES, INC	1/30/82	941	2575051	1343201	1,231,850	15
48)	HALLE BROTHERS CO	2/15/82	2168	6032000	3710599	2,321,401	4
49)	BOOTHE FINANCIAL CORP	2/28/82	52	1605400	551460	1,053,940	7
50)	MEYER BROTHERS DRUG CO	3/15/82	186	3131002	1738085	1,392,917	7

REVERSION OF ASSETS OT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
51)	WHITE STORES, INC	3/25/82	1250	7108302	2685863	4,422,439	1
52)	CENTRAL BANK OF DENVER	3/31/82	514	6295908	3982985	2,312,923	18
53)	WILPUTTE CORP	3/31/82	126	2680878	1503942	1,176,936	1
54)	MID-AMERICAN LINES, INC	4/01/82	175	1458296	457067	1,001,229	16
55)	BUXTON INCORPORATED	4/19/82	314	3100304	1824972	1,275,332	18
56)	WIMBERLY & THOMAS HARDWARE	4/22/82	152	1972647	732225	1,240,422	5
57)	HILLS-MCCANNA CO	4/23/82	310	4185262	2264308	1,920,954	1
58)	WESTERN AIR LINE, INC	4/29/82	2418	56400000	44559623	11,840,377	5
59)	GENERAL TIME CORP	5/14/82	1263	10640000	8050000	2,590,000	18
60)	GINO'S INC	5/20/82	1924	5928250	1428012	4,500,238	7
61)	DENTSPLY INTERNATIONAL INC	6/01/82	2073	24920000	13604240	11,315,760	18
62)	A G BECKER INCORPORATED	6/14/82	2915	22489203	11358911	11,130,292	6
63)	GATEWAY TRANSPORTATION CO, INC	6/14/82	754	8128369	5060875	3,067,494	2
64)	SMITH JONES INC	6/15/82	209	3627783	1709529	1,918,254	4
65)	DUPUIS, JEFFERSON, WAQUESPACK	6/21/82	10	1540098	154890	1,386,000	19
66)	FORSYTH DENTAL INFIRMARY FOR	6/25/82	132	1984000	781296	1,202,704	18
67)	LAVINO SHIPPING CO	6/28/82	539	5220000	4046627	1,173,373	18
68)	CHEMETRON CORP	6/30/82	48	1778897	703880	1,075,017	15
69)	CHROMALLOY FARM SYSTEMS, INC	6/30/82	188	3470004	2082735	1,387,269	1
70)	TRIANGLE PWC, INC	6/30/82	2006	20275000	12472000	7,803,000	1
71)	TIMEX CORP	6/30/82	2416	34840893	23118584	11,722,309	7
72)	INDUSTRIAL SERVICE CENTERS	6/30/82	123	2749889	1688142	1,061,747	1
73)	BESSIRE & CO, INCORPORATED	6/30/82	249	5019799	2172524	2,847,275	1
74)	TIMEX CORP	7/08/82	2539	10445152	5183946	5,261,206	18
75)	SECURITY PEOPLES TRUST CO	7/09/82	160	4500000	1500000	3,000,000	6
76)	BABCOCK & WILCOX CO	7/10/82	529	3449000	1939894	1,509,106	4
77)	FELTON CASTEEL, INC	8/01/82	224	5381667	2930270	2,451,397	5
78)	FISCHER & PORTER CO AND	8/31/82	683	7733000	4826190	2,906,810	18
79)	WBS, INC & ITS AFFILIATES	9/02/82	322	7533000	5949316	1,583,684	6
80)	BRANCH MOTOR EXPRESS CO	9/12/82	810	8760552	4228638	4,531,914	17
81)	RDC, INC	9/13/82	183	3311793	1454295	1,857,498	19
82)	GOTAAS-LARSEN, LTD	9/13/82	19	2469420	377241	2,092,179	2
83)	OLIVETTI HOLDING B V	9/13/82	5183	27290207	17566000	9,724,207	2
84)	BOYERTOWN CASKET CO	9/23/82	419	3833243	2364000	1,469,243	6
85)	TALMAN HOME FEDERAL SAVINGS	9/30/82	405	3146141	2111465	1,034,676	7
86)	SEABROOK FOODS, INC	9/30/82	2013	6422860	3833352	2,589,508	5
87)	CMI CORP & SUBSIDIARIES	9/30/82	1224	4988114	3130787	1,857,327	18
88)	FAMILY HEALTH ASSOC OF ARIZONA	10/01/82	346	2407017	930558	1,476,459	2
89)	PIGGLY WIGGLY OPERATORS	10/09/82	323	3370000	2282505	1,087,495	5
90)	SAVINGS BANK OF PUGET SOUND	10/28/82	219	5793666	3122882	2,670,784	18
91)	SUPERSCOPE, INC	10/28/82	330	3152283	2052612	1,099,671	5
92)	CONTINENTAL AIR LINES INC	10/31/82	7177	65971880	46350163	19,621,717	18
93)	TEXAS INTERNATIONAL AIRLINES	10/31/82	791	6872996	4731903	2,141,093	18
94)	SPECTOR RED BALL, INC	11/02/82	1707	10668460	8000000	2,668,460	16
95)	BUFFALO COURIER-EXPRESS CO	11/11/82	310	7003331	4095718	2,907,613	5
96)	BUFFALO COURIER-EXPRESS CO	11/11/82	270	5281469	3894417	1,387,052	5
97)	UNICON PRODUCING CO	11/11/82	109	3600000	1600000	2,00[illegible],000	18
98)	TIMEX CORP	11/15/82	2150	18339251	13835427	4,4[illegible]22	18
99)	SWANK, INC	11/30/82	[illegible]	13781755	6277012	7,5[illegible]743	19
100)	WESTERN AIR LINES, INC	11/30/82	1766	1[illegible]9900000	112[illegible]00000	17,00[illegible],000	5

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
101)	JOHN CRANE-HOUDAILLE, INC	12/10/82	2567	42487435	23989609	18,497,826	19
102)	R S FLING AND PARTNERS INC	12/14/82	84	1885707	847332	1,038,375	5
103)	FOREIGN-DOMESTIC DISTRIBUTORS	12/15/82	3	1482619	300000	1,182,619	1
104)	HOST INTERNATIONAL, INC	12/27/82	3048	8829049	4607320	4,221,729	18
105)	WHIRLPOOL CORP	12/30/82	262	3982080	2882571	1,099,509	4
106)	GAF CORP	12/31/82	8325	155900000	99900000	56,000,000	18
107)	MOTOR FREIGHT EXPRESS	12/31/82	358	2926827	711831	2,214,996	3
108)	UNICORN INDUSTRIES, INC	12/31/82	174	3716899	2385472	1,331,427	19
109)	HUMANA, INC	12/31/82	27002	103300000	51163159	52,136,841	18
110)	LANE BRYANT, INC	12/31/82	5926	40925000	26871453	14,053,547	18
111)	CHEMED CORP	12/31/82	1601	16613416	13200179	3,413,237	18
112)	MONEX CORP	12/31/82	467	1992904	676437	1,316,467	18
113)	BETHLEHEM STEEL CORP	12/31/82	824	11312882	9909700	1,403,182	6
114)	DUBUQUE PACKING CO	12/31/82	1155	14862489	13781983	1,080,506	1
115)	JAMES S KEMPER & CO	12/31/82	201	6241829	3911186	2,330,643	1
116)	ELECTRONIC MEMORIES AND	12/31/82	216	3508522	1213847	2,294,675	6
117)	SAV-ON DRUGS, INC	12/31/82	2537	9826835	6400000	3,426,835	1
118)	ALLIED SUPERMARKETS, INC	12/31/82	1588	12410000	7400000	5,010,000	18
119)	CLARK OIL & REFINING CORP	12/31/82	2072	18246923	6820205	11,426,718	6
120)	CLARK OIL & REFINING CORP	12/31/82	243	3679855	2237696	1,442,159	6
121)	NATIONAL SHAREDATA CORP	12/31/82	411	1592775	500000	1,092,775	3
122)	PAKO CORP	12/31/82	167	9365975	3090559	6,275,416	19
123)	KING'S DEPARTMENT STORES	12/31/82	9391	19218000	15793371	3,424,629	3
124)	CHROMIUM MINING & SMELTING	12/31/82	316	4711000	3559790	1,151,210	4
125)	QUESTOR CORP	1/02/83	564	19307180	5143879	14,163,301	18
126)	EMPIRE OF AMERICA FSA/DBA	1/03/83	172	2305364	986263	1,319,101	18
127)	FARRELL LINES INCORPORATED	1/03/83	581	10701771	9345000	1,356,771	18
128)	NEBRASKA FURNITURE MART INC	1/27/83	294	3589756	1771465	1,818,291	17
129)	HOWARD M LOFF, INC	1/30/83	2	1299747	200000	1,099,747	15
130)	HOUDAILLE INDUSTRIES, INC	1/31/83	438	6397371	3573392	2,823,979	4
131)	SWF HOLDINGS, INC	1/31/83	137	4194111	2212635	1,981,476	1
132)	UNITED FOODS, INC	2/24/83	470	8571133	3452053	5,119,080	18
133)	LINDSAY WIRE WEAVING CO	2/26/83	342	3927000	1837000	2,090,000	4
134)	FEDDERS CORP	2/28/83	1104	11095000	7444000	3,651,000	5
135)	LYTTON'S HENRY C LYTTON & CO	2/28/83	595	4231971	3207078	1,024,893	1
136)	INA STANDARD LIFE INSURANCE CO	2/28/83	53	2163718	1151370	1,012,348	1
137)	BUTCHER & SINGER, INC	2/28/83	509	5589935	2083461	3,506,474	6
138)	RIO INDAL, INC	3/05/83	6	1300000	120280	1,179,720	3
139)	ROBBIE BROOKS, INCORPORATED	3/11/83	1008	13560000	7542000	6,018,000	5
140)	LANSING B WARNER, INCORPORATED	3/28/83	249	4770967	3516256	1,254,711	19
141)	SEARLE OPTICAL INC	3/31/83	2258	6973000	3317586	3,655,414	18
142)	PATTERSON DENTAL CO	3/31/83	1391	11318939	8547667	2,771,272	18
143)	TILLIE LEWIS FOODS INC	3/31/83	309	6935951	2934297	4,001,654	4
144)	ELLISON CO INC	3/31/83	123	14726588	922145	13,804,443	6
145)	GLOBE TICKET CO	3/31/83	621	4890675	2789696	2,100,979	18
146)	GLOBE TICKET CO	3/31/83	760	2663153	1650836	1,012,317	18
147)	MADISON FUND, INC	4/01/83	43	2295091	986709	1,308,382	19
148)	GOLDENBERG PLYWOOD & LUMBER	4/04/83	13	1320382	128692	1,191,690	1
149)	NEW YORK INFIRMARY-BEEKMAN	4/11/83	576	5049389	3035095	2,014,294	18
150)	ROYAL COAL CO	4/11/83	[illegible]	2177627	1013469	1,164,158	5

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	PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
151)	BUTLER MANUFACTURING CO	4/15/83	691	9785558	6188705	3,596,853	18
152)	BUTLER MANUFACTURING CO	4/15/83	1311	27339770	16007844	11,331,926	18
153)	GULF & WESTERN CORP	4/15/83	1123	23302209	13808644	9,493,565	1
154)	GULF & WESTERN CORP	4/15/83	2428	5708738	1698752	4,009,986	1
155)	GULF & WESTERN CORP	4/15/83	1064	6518244	4419278	2,098,966	1
156)	SCOVILL INC	4/30/83	445	3091156	1812460	1,278,696	1
157)	TRW INC	4/30/83	419	3200000	1450000	1,750,000	19
158)	WILLIAM UNDERWOOD CO	4/30/83	591	10300000	6000000	4,300,000	18
159)	GRANITEVILLE CO	5/06/83	965	25709550	10338769	15,370,781	18
160)	KEWANEE INDUSTRIES INC	5/06/83	1064	12635286	10135286	2,500,000	1
161)	ALABAMA METAL INDUSTRIES CORP	5/16/83	111	2343750	817762	1,525,988	15
162)	KATZ COMMUNICATIONS INC	5/16/83	296	6283363	4458198	1,825,165	15
163)	HAEHN MANAGEMENT CO	5/27/83	3	118572372	108328293	10,244,079	19
164)	AM INTERNATIONAL, INC	5/31/83	12499	144174977	80947531	63,227,446	5
165)	MILLER AND CO	5/31/83	93	2908688	1699581	1,209,107	18
166)	INT'L TERMINAL OPERATING CO	5/31/83	427	4759563	3113700	1,645,863	2
167)	OCCIDENTAL PETROLEUM CORP	6/01/83	5536	80700000	33786000	46,914,000	18
168)	OCCIDENTAL CHEMICAL CORP	6/01/83	5435	132200000	80849000	51,351,000	18
169)	OCCIDENTAL CHEMICAL CORP	6/01/83	2367	51000000	18357000	32,643,000	18
170)	CITIES SERVICE CO	6/01/83	9392	573000000	335500000	237,500,000	18
171)	SEARLE MEDICAL PRODUCTS USA	6/01/83	1478	3321849	2125332	1,196,517	17
172)	SEARLE MEDICAL PRODUCTS USA	6/01/83	1059	7093831	4809837	2,283,994	1
173)	DAVIS WALKER CORP	6/03/83	233	4491620	1912053	2,579,567	18
174)	ROBERT COAL COMPANY	6/03/83	139	1335868	335000	1,000,868	5
175)	GRUNAU CO INC	6/05/83	201	3118936	1520935	1,598,001	5
176)	BALDWIN HOLDING CO	6/10/83	193	1704151	185000	1,519,151	1
177)	BALDWIN HOLDING CO	6/13/83	84	3755645	794750	2,960,895	1
178)	L S HEATH & SONS, INC	6/16/83	480	4607749	2669580	1,938,169	18
179)	DAN RIVER INC	6/18/83	5134	20790534	5195192	15,595,342	18
180)	SEYMOUR FOODS INC	6/30/83	181	2767184	1609045	1,158,139	18
181)	FIRSTMISS, INC	6/30/83	145	7677607	1479717	6,197,890	5
182)	MAYWOOD, INCORPORATED	6/30/83	357	4581235	1501799	3,079,436	6
183)	UNITED NUCLEAR CORP	6/30/83	1819	17995435	9821447	8,173,988	18
184)	CENTRAL SCREW DIVISION	6/30/83	183	2830991	1656807	1,174,184	3
185)	MERCHANTS MUTUAL INSURANCE CO	6/30/83	1755	10919210	4782457	6,136,753	15
186)	BROWN BOVERI ELECTRIC CO	6/30/83	154	6000000	3581973	2,418,027	15
187)	BROWN BOVERI ELECTRIC INC	6/30/83	206	3600000	2440139	1,159,861	15
188)	BROWN BOVERI ELECTRIC INC	6/30/83	71	7700000	2963644	4,736,356	6
189)	ROAMANS INC	6/30/83	306	3310947	1748166	1,562,781	18
190)	ARMSTRONG CONTAINERS INC	6/30/83	373	3677574	2300920	1,376,654	1
191)	PETER J SCHMITT CO INC	7/01/83	268	5362241	3355941	2,006,300	1
192)	U S OIL & GAS CORP	7/08/83	12	1764045	567369	1,196,676	1
193)	IU TRANSPORATION SERVICES	7/10/83	1209	21755000	7100000	14,355,000	2
194)	COOPER INDUSTRIES INC	7/18/83	602	11660597	7176800	4,483,797	4
195)	THE STATE EXCHANGE BANK	7/30/83	146	2358731	1232561	1,126,170	6
196)	RONGAIRE CORP	7/31/83	644	3873470	2388754	1,484,724	1
197)	FELER INDUSTRIES CORP	7/31/83	961	8647054	4605042	4,042,012	18
198)	ARCH MINERAL CORP	7/31/83	115	2568298	602420	1,965,878	18
199)	TEXAS METAL WORKS INC	7/31/83	173	4953057	3697204	1,255,853	18
200)	MEDICINE BOW COAL COMPANY	7/31/83	49	2580000	447900	2,132,100	18

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME1	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
201)	HAWTHORN MELLODY, INC	8/01/83	162	1981252	891846	1,089,406	18
202)	BALL & SOCKET MANUFACTURING	8/01/83	108	2504318	995412	1,508,906	1
203)	MEAD CORPORATION	8/01/83	1262	23563860	13232306	10,331,554	1
204)	DAN RIVER INC	8/07/83	7548	30788000	26799344	3,988,656	18
205)	JENNISON-WRIGHT CORP	8/11/83	100	3493714	1970659	1,523,055	19
206)	SCRIBNER BOOK CO, INC	8/11/83	286	5166000	2935000	2,231,000	5
207)	AMAX, INC	8/19/83	1291	189000000	65000000	124,000,000	18
208)	REYNOLDS METALS COMPANY	8/22/83	12048	390000000	264000000	126,000,000	18
209)	STATE BANK OF SAVINGS	8/28/83	121	2800098	1496039	1,304,059	2
210)	OLD B CO INC FORMERLY THE	8/31/83	176	2842664	1806275	1,036,389	1
211)	FIRST CHARTER FINANCIAL CORP	9/02/83	1738	8544755	6271183	2,273,572	1
212)	WHEELING MACHINE PRODUCTS CO	9/03/83	753	12125278	9200000	2,925,278	5
213)	INGREDIENT TECHNOLOGY CORP	9/06/83	284	4765000	2442988	2,322,012	18
214)	CORNELL-DUBILIER ELECTRIC CORP	9/12/83	349	4676470	3511456	1,165,014	1
215)	HAPPY HOMES, INC OF PINELLAS	9/16/83	3	1340043	300000	1,040,043	19
216)	MATTEL, INC	9/22/83	2426	26108000	12116000	13,992,000	18
217)	GIFFELS ASSOCIATES, INC	9/23/83	771	6122076	4231536	1,890,540	19
218)	BROWN BOVERI CORP	9/30/83	16	7000000	1000000	6,000,000	19
219)	NORTHERN NATIONAL CORP	9/30/83	1100	14785526	11000000	3,785,526	2
220)	INCO ELECTROENERGY CORP	9/30/83	1926	58537000	24159000	34,378,000	1
221)	AUTOMOTIVE SHIFTERS, INC	9/30/83	122	1524719	494347	1,030,372	19
222)	BENEFICIAL CORP	10/01/83	7878	83839474	38700000	45,139,474	18
223)	CITIES OFFSHORE PRODUCTION	10/01/83	516	6626000	3813632	2,812,368	1
224)	CITIES OFFSHORE PRODUCTION CO	10/01/83	986	13574100	7673556	5,900,544	3
225)	CITIES OFFSHORE PRODUCTION CO	10/01/83	2197	38905500	23746559	15,158,941	1
226)	CITIES OFFSHORE PRODUCTION CO	10/01/83	894	15785100	11277398	4,507,702	1
227)	CITIES OFFSHORE PRODUCTION CO	10/01/83	645	18294200	9291788	9,002,412	1
228)	LYNCHBURG FOUNDRY CO	10/03/83	2333	37731429	24133000	13,598,429	1
229)	LYNCHBURG FOUNDRY CO	10/03/83	473	2558343	644000	1,914,343	1
230)	WILMINGTON INVESTMENTS, INC	10/03/83	40	1870000	229118	1,640,882	1
231)	STROH BREWERY CO	10/14/83	3876	183767865	85795412	97,972,453	18
232)	COLBERT TELEVISION SYNDICATION	10/15/83	5	1596608	306351	1,290,257	7
233)	W T RAWLEIGH COMPANY	10/29/83	293	4747000	2090827	2,656,173	1
234)	TEXAS STEEL COMPANY	10/30/83	265	6090445	4744467	1,345,978	5
235)	GENERAL REFRACTORIES CO	10/31/83	24	6600910	415021	6,185,889	7
236)	NORMAN ENGINEERING CO	11/15/83	83	1598609	569230	1,029,379	19
237)	HOLLAND AMERICA LINE USA INC	11/28/83	526	5134661	3967424	1,167,237	3
238)	CLEVELAND GEAR CO	12/01/83	215	7180000	4823732	2,356,268	5
239)	UPPER CUMBERLAND ELECTRIC	12/01/83	111	2380722	1237833	1,142,889	18
240)	NATIONAL VALVE & MANUFACTURING	12/09/83	309	5697348	2924687	2,772,661	1
241)	THE MARTIN-BROWER COMPANY	12/10/83	599	2290352	811858	1,478,494	18
242)	ALLIED-GENERAL NUCLEAR	12/12/83	338	7310523	3446985	3,863,538	3
243)	WALLACE MACHINERY CO	12/15/83	13	4586431	131409	4,455,022	19
244)	RIVERSIDE COUNTY PUBLISHING CO	12/15/83	39	49132400	340000	48,792,400	1
245)	RAYMOND INTERNATIONAL INC	12/18/83	1046	73951999	42113178	31,838,821	18
246)	ARMOUR AND CO	12/19/83	1054	1[illegible]55501	[illegible]	95,000,000	1
247)	HEALTHCO, INC	12/24/83	916	7704202	5415000	2,289,202	18
248)	FACTS INDUSTRIES CORP	12/30/83	631	4113571	2819342	1,294,229	18
249)	GEORGIA-PACIFIC CORP	12/30/83	985	2892269	1583496	1,308,773	1
250)	GORDON FOOD SERVICE, INC	12/31/83	545	5620000	1892456	3,727,544	18

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	PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
251)	ARMOUR FOOD CO	12/31/83	1697	47903005	34803005	13,100,000	1
252)	FOREST CITY FOUNDRIES CO	12/31/83	663	5593110	4190621	1,402,489	3
253)	THE LONG ISLAND COLLEGE	12/31/83	1624	24147309	8917996	15,229,313	18
254)	UNITED CENTRAL BANCSHARES	12/31/83	774	6391598	3275905	3,115,693	18
255)	TALMAN HOME FEDERAL SAVINGS	12/31/83	157	4092302	2155784	1,936,518	5
256)	TRANSAMERICA FILM SERVICE	12/31/83	392	2322800	1220031	1,102,769	18
257)	MIRRO CORP	12/31/83	638	19050633	11590416	7,460,217	2
258)	MI INDUSTRIES INC	12/31/83	2908	38286188	16441419	21,844,769	18
259)	HAMADY BROS FOOD MARKETS, INC	12/31/83	276	3224110	1610583	1,613,527	5
260)	R B S INDUSTRIES INC	12/31/83	426	5169675	3948505	1,221,170	1
261)	R B S INDUSTRIES INC	12/31/83	418	5972437	3355310	2,617,127	1
262)	DOYLE DANE BERNBACH	12/31/83	1153	5010845	3043868	1,966,977	19
263)	COOPER INDUSTRIES, INC	12/31/83	173	1992430	517390	1,475,040	18
264)	FIRST NATIONAL SUPERMARKETS	12/31/83	1708	29306597	13484982	15,821,615	18
265)	MEARS COAL CO	12/31/83	30	1028856	27838	1,001,018	1
266)	C H MASLAND & SONS	12/31/83	622	8684733	5000000	3,684,733	18
267)	WHITING CORP	12/31/83	1216	47145617	22938318	24,207,299	1
268)	THE JACOBUS COMPANY	12/31/83	222	3702000	2016390	1,685,610	19
269)	NORTHWEST HOSPITAL	12/31/83	301	3317910	2201731	1,116,179	18
270)	CHATHAM SUPER MARKETS INC	12/31/83	359	5644538	1589188	4,055,350	5
271)	INTERSTATE BRANDS CORPORATION	12/31/83	4234	79837647	40311941	39,525,706	18
272)	TEXAS FEDERAL SAVINGS & LOAN	12/31/83	323	6390506	4647219	1,743,287	18
273)	COOPER INDUSTRIES, INC	12/31/83	687	4351183	2595620	1,755,563	18
274)	CONTINENTAL FEDERAL SAVINGS	12/31/83	181	3225600	2170178	1,055,422	18
275)	FIELD ENTERPRISES, INC	12/31/83	60	3368000	2202737	1,165,263	3
276)	CONGDON & CARPENTER CO	12/31/83	101	2262000	1147749	1,114,251	18
277)	SUN LIFE INSURANCE COMPANY	12/31/83	358	6795631	3487752	3,307,879	18
278)	MSM INC	12/31/83	153	2068495	729388	1,339,107	15
279)	INTEXT INC	1/01/84	538	6022128	3619037	2,403,091	18
280)	WEATHERFORD INTERNATIONAL INC	1/01/84	750	7140641	3506073	3,634,568	18
281)	ALBERT EQUIPMENT CO, INC	1/01/84	257	10242846	4570989	5,671,857	5
282)	CONTINENTAL SCALE CORP	1/02/84	239	2428951	1314221	1,114,730	1
283)	CARNEGIE-MELLON UNIVERSITY	1/02/84	139	5992939	2731546	3,261,393	19
284)	IMPERIAL KNIFE ASSOCIATED	1/03/84	1033	11155140	4585142	6,569,998	18
285)	TERSON CO, INC	1/03/84	1040	11510265	8911997	2,598,268	19
286)	COOPER INDUSTRIES, INC	1/06/84	760	7184666	3393684	3,790,982	18
287)	HEARST CORP	1/10/84	323	1781414	421267	1,360,147	18
288)	HEARST CORP	1/10/84	165	3817670	1172922	2,644,748	18
289)	SISTERS OF ST JOSEPH OF	1/13/84	2797	6100442	1646183	4,454,259	19
290)	HARSHAW/FILTROL PARTNERSHIP	1/20/84	512	19341287	7026000	12,813,287	1
291)	HARSHAW/FILTROLL PARTNERSHIP	1/20/84	752	35981045	14866000	21,115,045	1
292)	GILMORE STEEL CORP	1/23/84	635	22679300	11201096	11,478,204	19
293)	CELANESE CORP AND CONTROLLED	1/23/84	7292	430797009	105000009	325,797,000	19
294)	CONORS STEEL CO	1/26/84	375	7900723	4949000	2,951,723	3
295)	PEIRCE-PHELPS INC	1/30/84	301	5586675	4203600	1,383,075	18
296)	SIMPLICITY PATTERN CO: INC	1/31/84	650	6983728	3679000	3,304,728	18
297)	ALEXANDER HOWDEN GROUP US, INC	1/31/84	314	7584700	3732000	3,852,700	1
298)	CAPITAL STEEL CORP	1/31/84	156	7663447	4193421	3,470,026	19
299)	KOHN SAVETT MARION & GRAF	1/31/84	48	3408874	1315388	2,093,486	19
300)	NORLIN IND INC	1/31/84	79	3203224	1070204	2,133,020	5

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PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
301) INDUSTRIAL BOLT AND NUT CO	1/31/84	83	1801000	602000	1,199,000	5
302) NORLIN INDUSTRIES INC	1/31/84	403	4902323	1607217	3,295,106	5
303) NORLIN IND	1/31/84	813	16849677	8070236	8,779,441	5
304) WILSON FOODS CORP	2/01/84	3941	89073341	46609076	42,464,265	5
305) ROY M HUFFINGTON, INC	2/02/84	370	5113195	3537960	1,575,235	18
306) BRIL TRON INC	2/03/84	50	12558117	1258117	11,300,000	19
307) FEDERAL PAPER BOARD CO, INC	2/03/84	645	34120000	15790868	18,329,132	18
308) MCCONWAY AND TORLEY CORP	2/03/84	250	2774053	1625472	1,148,581	19
309) HOLCROFT/LOFTUS INC	2/06/84	258	6267729	3306638	2,961,091	18
310) WARREN TOOL CORP	2/06/84	67	2565089	1002735	1,562,354	4
311) B F WALKER, INC	2/10/84	143	3721083	2384638	1,336,445	1
312) EQUITABLE LIFE LEASING CORP	2/10/84	275	1724372	601073	1,123,299	4
313) WELDING ENGINEERS, INC	2/17/84	110	2723996	1624627	1,099,369	5
314) AMERIWAY SAVINGS ASSOC	2/27/84	59	2264005	178672	2,085,333	18
315) QUALITY BAKERS OF AMERICA	3/01/84	124	3983900	1906101	2,077,799	18
316) CERVECERIA CORONA, INC	3/01/84	133	2924060	1662513	1,261,547	5
317) RESEARCH COTTRELL INC	3/02/84	918	22192728	18072362	4,120,366	10
318) GRAND UNION CO	3/02/84	1396	22000000	8663608	13,336,392	1
319) J J HENRY CO INC	3/05/84	408	8676146	3743297	4,932,849	18
320) LIBERTY GLASS CO	3/07/84	183	3845606	2400000	1,445,606	18
321) THE VALLEY NATL BANK	3/09/84	6257	112000000	68000000	44,000,000	19
322) JENKINS BROS	3/12/84	294	11139074	8139074	3,000,000	5
323) TEM-COLE INC	3/12/84	154	3376115	2248946	1,127,169	19
324) KURTH MALTING CORP	3/12/84	43	1574300	555558	1,018,742	1
325) WINROCK ENTERPRISES, INC	3/15/84	107	2655314	492930	2,162,384	18
326) EYELET SPECIALTY CO INC	3/26/84	145	3507707	1856330	1,651,377	1
327) STANDARD-KNAPP, INC	3/30/84	242	5961671	2655085	3,306,586	18
328) INDUSTRIAL FABRICATING CO	3/31/84	207	1395491	354953	1,040,538	5
329) GREAT SOUTHWEST CORP	3/31/84	163	6346200	1691253	4,654,947	3
330) GREAT PLAINS COCA COLA	3/31/84	377	2206845	1077340	1,129,505	18
331) BANKERS TRUST CO	3/31/84	294	2351580	1081246	1,270,334	18
332) DROVERS BANK OF CHICAGO	3/31/84	296	7447945	5072800	2,375,145	18
333) JACOBS ENGINEERING GROUP INC	3/31/84	1147	13250000	7553017	5,696,983	5
334) YORK BARBELL COMPANY INC	3/31/84	134	2927101	664732	2,262,369	19
335) GF CORP	3/31/84	399	2179433	710768	1,468,665	4
336) DORCHESTER GAS CORP	3/31/84	374	9222229	4861633	4,360,596	1
337) AMERICAN SHIP BUILDING CO	3/31/84	1329	6829476	3593765	3,235,711	3
338) UHS OF BETHESDA, INC	4/01/84	283	2502519	1341004	1,161,515	1
339) STANDARD FORGE AND AXLE CO	4/01/84	299	2610087	1097900	1,512,187	5
340) THE JULIUS SCHEPPS CO	4/02/84	154	6600000	3900000	2,700,000	19
341) HALL CONTRACTING CORP	4/08/84	1055	4092405	2042607	2,049,798	19
342) FAULTLESS STARCH/BON AMI CO	4/09/84	112	2288093	989685	1,298,408	18
343) T I M E-DC INC	4/13/84	473	14913858	4774745	10,139,113	5
344) CROMPTON COMPANY INC	4/15/84	2106	7117042	3332267	3,784,775	18
345) LAMB TECHNICIAN CORP	4/15/84	959	3819698	2774766	1,044,932	18
346) BRUNO'S INC	4/15/84	391	4035358	1684466	2,350,892	18
347) CROMPTON CO, INC	4/15/84	604	7136457	3545991	3,590,466	18
348) DIAMOND INTL CORP	4/16/84	5402	116800000	50958712	65,841,288	3
349) [illegible] SYSTEMS, INC	4/30/84	936	4206681	3111876	1,094,805	18
350) BANK ADMINISTRATION INSTITUTE	4/30/84	12[illegible]	2774350	1734962	1,039,388	18

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME1	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
351)	DYNAMIT NOBEL-MARTE INC	4/30/84	107	2094905	944277	1,150,628	3
352)	MOONEY AIRCRAFT CORP	4/30/84	105	1427200	313583	1,113,617	2
353)	HERMAN CORP	5/01/84	56	2218277	695110	1,523,167	19
354)	NATIONAL BANK & TRUST CO	5/01/84	337	3823480	2073226	1,750,254	15
355)	FIRST TEXAS SAVINGS ASSOC	5/03/84	651	10352771	4577120	5,775,651	18
356)	REVERE SUGAR CORPORATION	5/05/84	360	6860000	3858226	3,001,774	5
357)	JOSEPH MAGNIN CO. INC	5/09/84	538	2680000	1174000	1,506,000	18
358)	A A CARBIDE SALES INC	5/12/84	2	28214664	2679883	25,534,781	5
359)	AMERICAN HOIST & DERRICK CO	5/15/84	1827	25904000	17308000	8,596,000	19
360)	IRECO CHEMICALS	5/15/84	270	3086418	754393	2,332,025	1
361)	WYATT INDUSTRIES INC	5/31/84	306	8362017	7339338	1,022,679	5
362)	GREAT ATLANTIC & PACIFIC TEA	5/31/84	27639	355090259	82134970	272,955,289	18
363)	SCHWERMAN TRUCKING CO	5/31/84	359	4384785	2498928	1,885,857	5
364)	FLINT STEEL CORP	5/31/84	431	3010347	928154	2,082,193	3
365)	MIDLAND GLASS COMPANY INC	5/31/84	411	3586455	1224140	2,362,315	1
366)	LONE STAR INDUSTRIES, INC	5/31/84	3337	101505354	59535912	41,969,442	18
367)	TEXAS PIPE BENDING CO	5/31/84	123	3253260	787497	2,465,763	18
368)	C E BICKFORD AND CO INC	5/31/84	3	1636042	300000	1,336,042	19
369)	SAM P WALLACE CO. INC	5/31/84	407	4503989	2406600	2,097,389	1
370)	TEXAS AUTOMATIC SPRINKLERS	5/31/84	121	5520227	3631767	1,888,460	1
371)	SUTRO & CO INCORPORATED	6/01/84	727	4527501	3019760	1,507,741	19
372)	TEXAS INDUSTRIES INC	6/01/84	3049	13643308	10931361	2,711,947	18
373)	MATHIS BROS FURNITURE CO INC	6/08/84	48	2758078	1633148	1,124,930	19
374)	IDEAL ROLLR & GRAPHICS CO	6/18/84	98	2110000	878076	1,231,924	1
375)	COFFEE-MAT	6/20/84	186	2001684	862340	1,139,344	19
376)	HAMILTON INDUSTRIES, INC	6/26/84	638	9655000	5420769	4,234,231	19
377)	UNION BANK AND TRUST CO	6/28/84	87	1535669	457978	1,077,691	18
378)	FIRST TULSA BANCORPORATION	6/29/84	820	17252657	10162910	7,089,747	2
379)	FIAT USA INC	6/30/84	491	3366724	1508184	1,858,540	5
380)	MEHARRY MEDICAL COLLEGE	6/30/84	1284	3400000	979454	2,420,546	18
381)	TOSCO CORPORATION	6/30/84	230	5041009	2059062	2,981,947	19
382)	THE FOLGER COFFEE COMPANY	6/30/84	281	4046097	511593	3,534,504	18
383)	CONE MILLS CORPORATION	6/30/84	2583	92441991	38041038	54,400,953	18
384)	PILOT FREIGHT CARRIERS INC	6/30/84	918	7484438	4723182	2,761,256	18
385)	DIXIE MACHINE WELDING & METAL	6/30/84	56	2088895	1013675	1,075,220	5
386)	WILLETT INC	6/30/84	118	2689598	1391323	1,298,275	18
387)	AMES DEPARTMENT STORES	6/30/84	2904	3000320	1329004	1,671,316	19
388)	CONE MILLS CORP	6/30/84	9300	32712887	19621422	13,091,465	18
389)	THE FIRST NATL BANK OF	7/01/84	310	5000282	2286124	2,714,158	18
390)	J P STEVENS & CO INC	7/01/84	9101	218288060	102800000	115,488,060	18
391)	ATLANTIC RICHFIELD CO	7/01/84	492	10788872	4503165	6,285,707	1
392)	BIG BEAR FARM STORES, INC	7/01/84	863	4952433	1640998	3,311,435	1
393)	JEFFERSON CO	7/02/84	119	2189938	743772	1,446,166	19
394)	TECUMSEH PRODUCTS CO	7/05/84	1514	21882751	10683525	11,199,226	5
395)	C SCHMIDT AND SONS INC	7/15/84	353	8145067	3638267	4,506,800	18
396)	BLACK AND DECKER INC	7/19/84	175	1742317	726000	1,016,317	19
397)	VALMONT INDUSTRIES, INC	7/22/84	719	7906000	6809715	1,096,285	18
398)	SEASONAIRE, INC	7/23/84	15	2640777	415347	2,225,430	18
399)	PENNSYLVANIA ENGINEERING CORP	7/30/84	356	4077927	1692319	2,385,608	18
400)	FIRST OKLAHOMA BANCORPORATION	7/31/84	1192	21672199	9290210	12,381,989	18

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME:	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
401)	MIDLAND-ROSS CORP	7/31/84	2270	11409153	9405900	2,003,253	18
402)	LANDMARK, INC	7/31/84	234	26121541	10851399	15,270,142	19
403)	UTICA NATL BANK AND TR	7/31/84	188	2281439	929110	1,352,329	5
404)	LIBERTY NATIONAL CORP	8/01/84	938	17332141	7252634	10,079,507	18
405)	HARNISCHFEGER CORP	8/01/84	2388	74739982	36730000	38,009,982	19
406)	UNIBANCORP	8/01/84	505	3943544	2025412	1,918,132	19
407)	ED THRASHER & ASSOCIATES, INC	8/03/84	3	2201915	201915	2,000,000	5
408)	BARRY WEHMILLER COMPANY	8/13/84	301	2849900	1761441	1,088,459	18
409)	SMITH BARNEY, HARRIS UPHAM	8/14/84	5260	34566470	21235761	13,330,709	19
410)	IREX CORP	8/31/84	649	10046009	6546009	3,500,000	18
411)	DENKA CHEMICAL CORP	8/31/84	212	1699357	628771	1,070,586	2
412)	SHELLER GLOBE CORPORATION	8/31/84	410	2646747	917496	1,729,251	19
413)	KNUDSEN CORP	8/31/84	531	10210000	4839668	5,370,332	19
414)	PETTIBONE CORP	8/31/84	1270	16397511	9896921	6,500,590	5
415)	LYON METAL PRODUCTS	8/31/84	1075	22300000	11269208	11,030,792	5
416)	FIRST NATIONAL BANK IN	8/31/84	227	6148578	2587037	3,561,541	18
417)	FONTAINE TRUCK EQUIPMENT CO	8/31/84	597	3983853	1494724	2,489,129	18
418)	FIRESTONE TIRE & RUBBER CO	9/01/84	25037	[illegible]654033	363000000	284,654,033	18
419)	AIR LINE PILOTS ASSOCIATION	9/03/84	214	8502829	3900663	4,602,166	18
420)	FARMERS & MECHANICS NATIONAL	9/04/84	296	4443840	2582829	1,861,011	18
421)	CRUTCHER RESOURCES CORP	9/14/84	1543	10150000	4550000	5,600,000	18
422)	MURCO DRILLING COMPANY	9/19/84	204	3276799	1007346	2,269,453	1
423)	FRANK B HALL CO INC	9/28/84	4568	51495935	34816896	16,679,039	5
424)	CITIES SERVICE OIL AND GAS	9/30/84	2433	99572599	39301000	60,271,599	19
425)	LAMPERT YARDS, INC	9/30/84	233	2699467	1294200	1,405,267	5
426)	SOULE' STEEL CO	9/30/84	374	5965069	4805214	1,159,855	19
427)	WM POWELL CO	9/30/84	273	5321824	3481927	1,839,897	5
428)	WM POWELL CO	9/30/84	1004	18438916	15984825	2,454,091	5
429)	CERRO METAL PRODUCTS	9/30/84	235	4613667	3358522	1,255,145	18
430)	NICHOLS HOMESHIELD INC	9/30/84	407	7426998	4047150	3,379,848	19
431)	LAMSON & SESSIONS CO	9/30/84	865	16103844	10542315	5,561,529	5
432)	CARLTON BUILDERS	9/30/84	3	1418232	300000	1,118,232	18
433)	KLING PARTNERSHIP	9/30/84	215	3192697	965329	2,227,368	18
434)	MOHAWK RUBBER CO	9/30/84	666	9429973	6196807	3,233,166	1
435)	BENEFICIAL STANDARD CORP	9/30/84	277	6551762	2540754	4,011,008	3
436)	MISTLETOE EXPRESS SERVICE	9/30/84	1225	5419493	3264832	2,154,661	19
437)	OHIO FARMERS GRAIN AND	9/30/84	229	3646886	1994296	1,652,590	18
438)	IRA WILSON SON DAIRY CO	10/01/84	80	1651460	565161	1,086,299	3
439)	US NEWS AND WORLD REPORT INC	10/01/84	660	32753127	14000000	18,753,127	1
440)	BEN FRANKLIN FED SAVINGS AND	10/01/84	392	5666441	2739946	2,926,495	1
441)	ARATEX SERVICES INC	10/01/84	392	7885958	2448078	5,437,880	19
442)	HART-CARTER CO	10/01/84	197	3552360	1781422	1,770,938	18
443)	TELEDYNE, INC	10/01/84	324	6133808	3779600	2,354,208	4
444)	FAY CORPORATION	10/01/84	1108	13617300	7380395	6,236,905	19
445)	FOURTH NATIONAL BANK OF TULSA	10/06/84	189	2931450	1753168	1,178,282	18
446)	MISSOURI DELTA COMMUNITY	10/15/84	479	23553703	11900479	11,653,224	18
447)	TAIT ENGINEERING INC	10/29/84	693	4364984	3110760	1,254,224	18
448)	WESTERN PUBLISHING CO, INC	10/31/84	1594	16445880	8752435	7,693,445	18
449)	LEXFORD INC	10/31/84	525	15870000	12450727	3,419,273	18
450)	FAIRFIELD MANUFACTURING CO	10/31/84	1157	24340000	11091045	13,248,955	18

REVERSION OF ASSETS GT $1000000 WITH N.O.S. ISSUED AS OF 4/30/85

	PLAN SPONSOR NAME1	D.O.T.	PARTS.	ASSETS	BENEFITS	REVERSION	TERM.REASON
451)	THE WILLIAM POWELL COMPANY	10/31/84	97	4912409	2863369	2,049,040	5
452)	A JOHNSON & CO, INC	11/01/84	111	2334449	1307485	1,026,964	1
453)	MCLEAN TRUCKING COMPANY	11/01/84	2226	34000000	22000000	12,000,000	18
454)	WOODINGS-VERONA TOOL WORKS	11/01/84	66	1897863	707040	1,190,823	18
455)	HUTTING SASH & DOOR CO	11/05/84	530	11682000	4853365	6,828,635	19
456)	ST REGIS CORPORATION	12/10/84	9964	280891213	192264661	88,626,552	1
457)	DATACOMP CORPORATION	12/14/84	453	3390791	2201859	1,188,932	18
458)	FIELD COMMUNICATIONS CORP	12/15/84	0	2644965	0	2,644,965	3
459)	SMITH'S TRANSFER CORP	12/17/84	227	23959500	5829676	18,129,824	19
460)	THE HOME INSURANCE CO	12/28/84	7346	148820952	83820952	65,000,000	18
461)	STANDARD FINANCIAL CORP	12/31/84	78	3194296	1665296	1,529,000	18
462)	EES INSURANCE OF WAUSAU A	12/31/84	9493	218888464	106546000	112,342,464	19
463)	STERLING NATIONAL BANK & TRUST	12/31/84	369	6808205	1977205	4,831,000	18
464)	NEW AMERICAN LIBRARY	12/31/84	260	5100000	1961375	3,138,625	18
465)	RTE CORP	12/31/84	906	10800000	5829080	4,970,920	18
466)	MEDUSA CORP	12/31/84	101	1495100	409223	1,085,877	19
467)	CRANE CO	12/31/84	741	26807318	23129972	3,677,346	19
468)	ITT NORTH TELECOMMUNICATIONS	12/31/84	749	6849625	2300625	4,549,000	4
469)	MERCHANTS FAST MOTOR LINES INC	12/31/84	1831	35159591	18275126	16,884,465	18
470)	WHIRLPOOL CORP	12/31/84	1615	19800000	16100000	3,700,000	4
471)	INTERNATIONAL PAINT CO INC	12/31/84	217	2995954	1365270	1,630,684	18
472)	ELLERBE, INCORPORATED	12/31/84	914	12186600	7469392	4,717,208	5
473)	COCA-COLA BOTTLERS OF DETROIT	12/31/84	217	2722497	1660159	1,062,338	18
474)	NUTRI SYSTEM INC	3/04/85	984	2897806	1601804	1,296,002	18
			576071	9572893532	5016891054	4,556,002,478	

* LIST CASE SPON1 EVA EVB AB CNAME

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Categories: Status of Successor Plan

A = Spinoff
B = Def. Benefit Plan (Complete Term.)
C = Def. Contribution Plan (Complete Term.)
D = No New Plan (Complete Term.)

Reasons for Termination:

1 = Change of Company ownership by sale, transfer
2 = Company merger
3 = Liquidation or dissolution of employer
4 = Closing of subsidiary, division or plant
5 = Adverse business conditions
6 = Plan too costly to maintain, no reference to ERISA
7 = ERISA impact
15 = Employer or employees dissatisfied with present plan - no reference to ERISA
16 = Bankruptcy
17 = No reason given, unknown
18 = Adoption of new superceding plan
19 = Other, not cited above

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
A	Bekins	12-31-83	$ 20.0M	$ 12.0M	$ 8.0M	1,500	1
A	Peavy Company	02-15-84	48.8M	28.8M	20.0M	1,157	2
A	GAF	09-02-84	86.0M	68.0M	18.0M	7,380	19
A	Western Union	10-19-81	3.9M	2.0M	1.9M	433	4
A	Itel Corp.	07-31-84	14.2M	3.9M	10.3M	1,185	19
A	Barnes and Tucker	07-01-84	9.6M	3.6M	6.0M	217	19
A	Timken Company	11-01-84	278.0M	158.0M	120.0M	5,482	18
A	Medusa Corp.	12-31-84	11.0M	2.2M	8.8M	210	18
A	Alladin Ind.	11-01-84	16.0M	5.5M	10.5M	574	19
A	Kelley Mfg.	12-31-84	2.2M	.5M	1.7M	34	19
A	Getty Oil (Texaco)	12-31-84	689.0M	439.0M	250.0M	18,739	1
A	First Miss. Natl.	12-31-84	2.8M	1.6M	1.2M	30	19
A	Coca Cola Bottling	12-31-84	9.3M	5.8M	3.5M	829	5
A	Lee Natl. Corp.	12-31-84	2.4M	1.2M	1.2M	65	18
A	Heritage Wisc.	12-31-84	2.6M	1.6M	1.0M	124	19
A	Frontier Airline (3 plans)	12-31-84	159.0M	108.0M	51.0M	272	18
A	Andal Corp.	01-31-85	3.0M	1.6M	1.4M	175	19
A	INCO Ltd.	01-31-85	234.1M	118.1M	116.0M	3,983	18
A	Yale Industrial	01-31-85	6.6M	5.1M	1.5M	287	18
A	United Refining	10-01-84	13.6M	4.6M	9.0M	227	18
A	C.A. Portland Cement	12-31-84	16.9M	12.9M	4.0M	559	2
A	Great Lakes Carbon (salaried)	12-31-84	52.5M	28.8M	23.7M	1,269	18
A	Great Lakes Carbon (hourly)	02-28-85	23.3M	7.9M	15.4M	1,548	18
A	Boothe Newspapers	10-01-82	5.9M	4.7M	1.2M	511	19
A	Kaneb Services	12-31-84	7.6M	.3M	7.3M	43	18
A	Atlantic Packaging	12-01-84	.7M	.4M	.3M	68	5
A	Vitro Engineering	02-01-85	1.3M	0	1.3M	0	19
A	Monarc Wine	03-15-85	4.3M	3.3M	1.0M	128	19
A	Overhead Door	12-31-84	1.2M	.8M	.4M	845	6
A	W.L.S. Stamping	04-15-85	2.2M	1.0M	1.2M	7	19
A	Bulova Watch	12-31-84	63.5M	35.5M	28.0M	2,374	19
A	Bank of Hawaii	04-30-85	35.0M	4.0M	31.0M	256	19

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
A	Allegheny, Int.	03-15-85	$ 4.5M	$ 1.8M	$ 2.7M	54	1
A	Dr. Pepper	03-01-85	15.0M	10.0M	5.0M	106	1
A	Acme Visible Records	12-31-84	10.0M	5.0M	5.0M	1,216	18
A	Purex (2 plans)	03-31-85	54.0M	42.0M	12.0M	1,400	18
A	Citizens Utilities	01-14-85	33.9M	5.9M	28.0M	232	19
A	Food Giant	12-28-84	8.1M	7.1M	1.0M	47	18
	Subtotal		$1,952.0M	$1,142.5M	$809.5M	53,566	
B	Pabst	10-31-84	40.0M	28.0M	12.0M	1,720	18
B	Agra-Land	10-31-84	7.8M	4.5M	3.3M	534	18
B	Barton Mines	11-30-84	3.3M	1.7M	1.6M	232	18
B	National Cement	08-31-84	2.2M	1.2M	1.0M	65	18
B	Walbro	12-31-84	2.8M	1.1M	1.7M	265	18
B	Midwest Commerce	01-01-85	7.6M	3.6M	4.0M	499	18
B	Portec, Inc.	12-31-84	15.6M	8.3M	7.3M	847	18
B	Genstar	02-21-85	75.0M	40.0M	35.0M	3,061	18
B	AMF	12-03-84	191.3M	108.2M	83.1M	8,000	18
B	Redland Prism	12-31-84	2.0M	1.0M	1.0M	171	18
B	Conversion Systems	12-31-84	3.1M	1.1M	2.0M	213	18
B	California Portland	12-31-84	16.8M	12.8M	4.0M	559	1
B	Smithfield Packing	12-31-84	5.8M	2.8M	3.0M	347	5
B	Central Bancorporation	12-31-84	27.3M	18.6M	8.7M	3,058	18
B	Superior Oil (Mobil) (2 plans)	12-31-84	136.0M	107.0M	29.0M	4,082	1
B	First NH Banks	01-01-85	9.8M	4.8M	5.0M	658	18
B	Dollar Bank (2 plans)	01-31-85	10.0M	5.75M	4.25M	1,050	18
B	Wheeling Dollar Savings	12-31-84	5.1M	2.1M	3.0M	197	18
B	Chubb Corp. (2 plans)	01-21-85	165.0M	77.5M	87.5M	7,037	19
B	Leesona Corp.	12-31-84	18.0M	12.0M	6.0M	1,335	18
B	H.D. Huson	12-31-84	8.7M	4.1M	4.6M	177	18
B	HMW Industries	03-31-84	25.6M	17.0M	8.6M	1,490	19
B	American Bank Note	12-30-84	21.6M	18.6M	3.0M	818	18
B	Allied Materials	12-31-84	3.0M	1.7M	1.3M	106	18
B	McQuay (2 plans)	04-19-85	19.6M	13.0M	6.6M	2,757	1
B	American Express	04-30-85	198.5M	108.5M	90.0M	20,999	18

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
B	Davy Co.	01-31-85	$ 70.0M	$ 30.0M	$ 40.0M	2,929	19
B	Scholastic, Inc.	01-31-85	13.5M	9.0M	4.5M	960	18
B	Wean United	12-31-84	57.9M	47.9M	10.0M	1,820	18
B	Alco Power	02-15-85	11.5M	10.0M	1.5M	303	4
B	Freeport Kaolin	02-28-85	8.7M	4.7M	4.0M	551	4
B	Ellwood City Forge	02-28-85	8.9M	6.0M	2.9M	440	18
B	Anchor/Darling	03-15-85	10.2M	6.5M	3.7M	547	18
B	Southwestern Portland Cement	02-15-85	25.0M	16.0M	9.0M	556	18
B	Warner Co.	02-28-85	3.2M	2.2M	1.0M	276	18
B	National Mine	03-01-85	11.0M	7.7M	3.3M	812	18
B	Valero Energy	03-01-85	27.3M	11.8M	15.5M	2,146	18
B	Dura Corp.	03-04-85	3.4M	2.0M	1.4M	285	18
B	Harvest States	02-28-85	15.0M	11.0M	4.0M	846	5
B	Fireman's Fund Ins.	03-18-85	295.0M	175.0M	120.0M	16,895	18
B	Boston Company	03-18-85	21.4M	12.4M	9.0M	1,141	18
B	Commercial Union Ins.	03-20-85	175.0M	125.0M	50.0M	7,840	5
B	Ticor	03-29-85	110.0M	70.0M	40.0M	7,917	19
B	American Mutual Ins.	03-31-85	79.7M	59.7M	20.0M	2,948	18
B	Edgcomb Steel	03-31-85	4.7M	1.7M	3.0M	437	1
B	Beckwith Machinery	03-31-85	11.0M	5.0M	6.0M	362	19
B	Bremer Financial	03-31-85	16.1M	8.9M	7.2M	1,230	18
B	Lakeside Natl. Bank	03-31-85	3.6M	2.5M	1.1M	124	18
B	USM-Bailey Div.	04-01-85	5.6M	3.2M	2.4M	644	19
B	Medley Distill.	12-15-84	2.6M	1.4M	1.2M	212	18
B	Franklin Mint	04-30-85	25.1M	19.1M	6.0M	1,663	1
B	Kewaunee Scientific	04-30-85	4.0M	1.3M	2.7M	274	18
B	Hawaiian Trust Co.	04-30-85	8.2M	5.4M	2.8M	323	18
B	Development Corp.	12-31-83	4.2M	3.0M	1.2M	680	19
	Subtotal		$2,053.3M	$1,263.35M	$789.95M	115,438	
C	Economy Forms (3 plans)	03-31-85	5.3M	2.7M	2.6M	421	18
C	Reliable Stores	12-31-84	12.1M	6.7M	5.4M	1,054	18
C	U.S. Cold Storage	12-31-84	12.0M	9.0M	3.0M	331	18
C	Kalex Chemical	09-30-84	3.8M	1.8M	2.0M	186	18
C	McLean Trucking	10-31-84	30.0M	16.0M	14.0M	2,226	18

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Participants	Reason for Termination
C	Crystal Oil	12-01-84	$ 5.7M	$ 3.8M	$ 1.9M	361	18
C	Rich Products	12-31-84	5.8M	4.5M	1.3M	666	18
C	Stearns and Foster	12-01-84	5.8M	3.4M	2.4M	333	1
C	New York Twist Drill (2 plans)	12-20-84	5.2M	2.9M	2.3M	519	18
C	Columbia Artists	12-17-84	1.9M	.9M	1.0M	159	5
C	Bata Shoe	10-31-84	7.5M	4.0M	3.5M	1,409	18
C	GAI-Tronics	03-31-85	2.1M	1.1M	1.0M	283	18
C	Chloride, Inc.	03-31-85	10.8M	6.3M	4.5M	1,610	5
C	DeLenav Cather	12-31-84	9.3M	5.8M	3.5M	987	18
C	Wood Gundy	03-31-85	2.8M	.8M	2.0M	98	18
C	Mincorp	03-31-85	4.3M	1.8M	2.5M	645	18
C	Macklanburg-Duncan	04-10-85	16.6M	7.6M	9.0M	1,173	18
C	McCalls	01-01-85	6.1M	4.1M	2.0M	683	19
C	Polyveral	02-28-85	2.5M	.8M	1.7M	216	18
C	Equitable Savings	10-01-84	5.7M	3.7M	2.0M	392	18
C	Saver Industries	12-31-84	3.6M	1.5M	2.1M	277	18
C	Ohio Crankshaft	12-31-84	10.5M	8.0M	2.5M	393	18
C	Methodist Hospital	10-04-84	3.4M	2.1M	1.3M	779	18
C	Russell, Burdsall (2 plans)	12-31-84	25.3M	15.2M	10.1M	255	18
C	Allied Bank	10-31-84	3.1M	.7M	2.4M	95	18
C	Sauer Industries	12-31-84	3.0M	.9M	2.1M	276	18
C	Harcourt Brace Jovanovich	12-31-84	80.0M	33.8M	46.2M	5,027	18
C	Schneider, Inc.	12-31-84	9.8M	5.3M	4.5M	1,369	18
C	Pacific Savings Bank	12-31-84	5.7M	3.7M	2.0M	500	18
C	Bank of Oklahoma	12-31-84	6.9M	5.1M	1.8M	809	18
C	Ludlow Corp.	12-31-84	8.4M	4.4M	4.0M	847	18
C	Financial Fed. Sav.	12-31-84	14.3M	10.3M	4.0M	335	5
C	Platt Saco	12-31-84	12.5M	6.6M	5.9M	616	18
C	S.J. Groves	04-30-85	6.9M	5.1M	1.8M	1,307	18
C	Oklahoma Medical Research	04-30-85	3.2M	1.9M	1.3M	210	5
C	Bishopric	04-30-85	2.8M	1.6M	1.2M	177	5

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
C	Trompeter Electronics	01-31-85	$ 5.8M	$ 4.1M	$ 1.7M	79	19
C	Equimark	01-31-85	21.8M	13.8M	8.0M	2,355	18
C	Moyer Packing	02-01-85	4.5M	3.0M	1.5M	381	18
C	Creasey Co.	01-31-85	2.9M	1.6M	1.3M	266	18
C	Foregren	12-31-84	4.0M	2.8M	1.2M	94	5
C	Centinela Hospital	12-31-84	6.5M	3.0M	3.5M	1,329	18
C	Amerace	12-31-84	36.0M	20.0M	16.0M	2,184	18
C	Bird Incorporated (3 plans)	12-31-84	30.0M	24.0M	6.0M	2,625	5
C	Northwestern Financial Corp.	12-31-84	25.5M	8.0M	17.5M	3,398	18
C	IU Intl. Mgmt. Corp.	12-31-84	10.5M	6.0M	4.5M	215	18
C	Copps Corp.	12-31-84	5.5M	3.0M	2.5M	747	18
C	American Stores	12-31-84	191.0M	171.0M	20.0M	10,015	1
C	Anderson Greenwood	12-31-84	7.7M	6.2M	1.5M	510	18
C	Rochester Community	12-31-84	14.9M	8.2M	6.7M	845	18
C	Kerotest Mfg. Corp.	12-31-84	2.6M	1.3M	1.3M	112	18
C	Park Ohio Industries	12-31-84	6.9M	4.4M	2.5M	254	18
C	C.R. Anthony Co.	12-31-84	15.0M	9.3M	5.7M	3,765	18
C	American Sterilizer	01-07-85	50.7M	49.2M	1.5M	2,020	18
C	Philadelphia College of Pharmacy	02-07-85	4.0M	2.0M	2.0M	238	18
C	Pacwest Bancorp	02-01-85	8.2M	4.2M	4.0M	671	18
C	T. Smith & Son	02-28-85	5.4M	3.0M	2.4M	142	18
C	Adler-Royal	07-31-84	24.0M	22.0M	2.0M	3,334	18
C	Van Pelt	08-31-84	3.5M	1.5M	2.0M	206	5
C	Leesonia	12-31-84	17.9M	11.6M	6.3M	1,335	6
C	Verdugo Hills	12-31-84	3.4M	1.6M	1.8M	597	18
C	Dixon Ticonderoga	12-31-84	4.3M	3.2M	1.1M	207	18
C	LaBarge	12-31-84	1.6M	.6M	1.0M	266	18
C	Hertzfeld & Rubin	09-30-84	2.2M	.8M	1.4M	115	18
C	Capitol Industries	03-31-85	7.2M	5.2M	2.0M	1,262	18
C	First Merchant Bank	04-30-85	1.7M	.6M	1.1M	149	18
C	Braum's Ice Cream	11-30-84	2.0M	.8M	1.2M	501	18

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
C	Lipe-Rollway	11-30-84	$ 6.6M	$ 5.1M	$ 1.5M	432	18
C	Black Clawson	12-31-84	8.4M	7.4M	1.0M	668	18
C	Albany Medical	06-30-84	8.0M	5.9M	2.1M	310	18
	Subtotal		$904.9M	$608.3M	$296.6M	68,651	
D	Boston Consulting	12-31-83	11.0M	8.0M	3.0M	339	16
D	Charlotte City Coach	11-30-84	1.9M	.7M	1.2M	89	3
D	Dorchester Refining	10-15-84	3.9M	1.3M	2.6M	164	4
D	Industrial Cylinder	11-30-84	4.9M	2.4M	2.5M	269	4
D	Guild Winery	10-19-84	4.5M	2.8M	1.7M	147	1
D	Harris Methodist	08-02-84	17.8M	10.4M	7.4M	1,967	6
D	Woodings-Verona	11-15-84	3.9M	2.3M	1.6M	150	6
D	Admiral	11-10-84	4.0M	.1M	3.9M	1,262	6
D	Ingram	11-30-84	5.3M	2.3M	3.0M	418	5
D	1st Lincoln	09-12-84	3.0M	1.6M	1.4M	306	1
D	Ideal Roller	06-18-84	2.1M	.9M	1.2M	98	1
D	B&L Motor Freight	12-31-84	2.3M	1.0M	1.3M	93	1
D	Delta Steamship	12-31-84	9.5M	7.7M	1.8M	583	3
D	Fagersta	12-31-84	3.4M	2.4M	1.0M	50	1
D	Food Giant Inc.	12-28-84	7.1M	5.4M	1.7M	493	1
D	USM-Farrel Div.	04-01-85	5.5M	4.0M	1.5M	497	4
D	Robintech	03-31-85	7.0M	3.5M	3.5M	652	1
D	Winona Mem. Founda.	04-08-85	9.6M	4.6M	5.0M	1,200	1
D	Louisville Cement	02-19-85	12.0M	7.5M	4.5M	208	1
D	Tremor Equipment	03-31-85	6.4M	4.1M	2.3M	205	5
D	Schneider, Inc.	12-31-84	9.8M	5.3M	4.5M	1,369	15
D	Management Assist.	12-31-84	12.2M	6.0M	6.2M	3,011	3
D	Salem Hospital	12-31-84	6.1M	3.1M	3.0M	812	3
D	Electrolux	01-31-85	5.1M	3.2M	1.9M	833	4
D	Jonathan Logan	12-31-84	40.0M	25.0M	15.0M	2,166	19
D	Daily Telegraph	01-01-85	7.8M	1.6M	6.2M	110	1
D	Lowe Paper	07-30-84	6.3M	3.1M	3.2M	321	1
D	Diamond International	05-01-85	31.8M	19.8M	12.0M	4,548	3
D	A&H Truck	11-30-84	4.9M	2.6M	2.3M	107	5
D	Allegheny	03-15-85	4.4M	1.7M	2.7M	54	1

CURRENTLY PENDING CASES IN PBGC WITH EXCESS ASSETS

Category	Plan Sponsor	DOT	Assets	Benefits	Reversion	Parti-cipants	Reason for Termination
D	Liberty House	09-30-84	$ 3.7M	$ 2.5M	$ 1.2M	1,343	1
D	Sylbron	07-30-84	42.7M	26.6M	16.1M	3,024	1
D	Huffman Koos	01-31-85	5.0M	1.9M	3.1M	576	4
D	Household Merchandising	01-31-85	3.5M	2.0M	1.5M	394	4
D	Misener Marine	01-31-85	3.7M	2.5M	1.2M	279	19
D	Norton Simon	03-01-85	6.5M	1.6M	4.9M	155	4
D	Toledo	12-31-84	17.2M	9.7M	7.5M	1,249	19
D	Fontaine Truck	05-31-84	3.6M	1.4M	2.2M	597	15
D	Continental Pilots	03-09-84	65.0M	64.0M	1.0M	1,712	16
D	Petro-Tex Chemical	11-30-84	22.0M	12.0M	10.0M	800	19
D	Ford, Bacon & Davis	09-10-84	5.6M	2.3M	3.3M	325	19
D	Continental Fed.	01-31-85	6.0M	4.8M	1.2M	404	5
D	Allied Materials	12-31-84	2.4M	1.0M	1.4M	171	1
D	Di-Acro	08-31-84	2.7M	1.2M	1.5M	135	1
D	Denka Chemical	08-31-84	1.7M	.7M	1.0M	212	1
	Subtotal		$444.8M	$278.6M	$166.2M	33,897	
	GRAND TOTAL		$5,355.0M	$3,292.75M	$2,062.25M	271,552	

APPENDIX VII

ISSUES SURROUNDING PENSION TERMINATIONS FOR REVERSION

Richard A. Ippolito*/

Most workers covered by pension plans in the U.S. belong to defined benefit plans, not defined contribution plans (like TIAA-CREF).1/ Defined contribution plans are akin to tax-preferred savings accounts: the value of the account is retained by workers after short vesting periods even if the firm terminates the plan. Upon retirement, the value of the account is taken as a lump sum or annuity.2/ Defined benefit plans promise pension annuities starting at retirement which are proportional to years of service and final wage.3/ The responsibility for funding these plans lies with the corporate sponsor.

The firm can legally terminate a pension plan anytime. When it terminates a defined benefit plan, large capital losses are imposed on workers: this is so because from a legal perspective, upon termination, the firm owes workers unindexed benefits payable many years in the future, not real benefits which may generally be implied by firms and expected by workers. In this sense, terminations could represent the breaking of long term implicit pension contracts. In addition, terminations by some firms could lead to widespread distrust of defined benefit plans, making these plans uneconomic as compensation devices even though they may offer unique benefits to firms and workers.

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*/ U.S. Department of Labor. The views expressed in this paper are those of the author, and therefore do not necessarily represent the position of the U.S. Department of Labor.

1/ Approximately 80 percent of workers covered by pensions are covered primarily by defined benefit plans.

2/ An exception to this rule is TIAA-CREF which requires participants to take annuities.

3/ The formula might include final wage, average of the highest three salary years or some other similar variant.

The problem is exacerbated when terminations occur in pension plans where assets held in trust exceed legal benefits. Since trust assets are presumably set aside to pay pensions, it might reasonably be inferred that they are not intended for other corporate purposes. But in virtually all cases, "excess" assets in terminated plans (assets in trust minus legal benefits) revert to stockholders, not workers. This creates a class of terminations which are the subject of this paper: pension terminations for reversion.

The termination for reversion phenomenon has raised fundamental questions about pensions. Are these terminations violations of implicit contracts? Should trust assets belong to workers? Are there hidden conditions in pension contracts that permit terminations of apparently healthy plans under some conditions? In times of high inflation, did the law intend to protect a relatively small portion of real benefits? Did the law envision the emergence of such large "legal excesses" in plans? Were the large tax subsides embedded in reversions contemplated or intended?

In this paper, the economic issues surrounding terminations for reversion are brought together; and available evidence describing and perhaps explaining these terminations is considered and evaluated. The results show that while reversions have been increasing rapidly in recent years, it is still an anomoly in defined benefit plans: the pension promise is inviolate for the vast majority of firms and workers. Moreover, available data appear to contradict the notion that terminations are effected for the purpose of imposing capital losses on workers and granting capital gains to stockholders. Instead, the findings tend to support the notion that terminations reflect firms' intentions to in effect borrow funds from the pension plan. This finding contradicts the generally accepted notion that firms should fully fund their pension funds, taking advantage of their tax exempt status.

The results support various changes in public policy towards pensions, including the institution of a reversion tax and the revision of pension borrowing rules. Legal mechanisms permitting firms the opportunity of creating irrevocable trusts also should be erected. Otherwise, there is little support from the termination phenomenon to justify more fundamental changes in current pension policy.

I. ECONOMIC ASPECTS OF TERMINATIONS FOR REVERSION

A. Impact of Terminations on Worker Pension Wealth

Consider the economic impact of terminations for workers. Unless firms take elaborate steps to offset their impact (see below), terminations impose large capital losses on workers. This fact lay at the core of public policy concern about pension plan terminations; and hence its understanding is central to rational discourse about policy options.

First, consider the legal pension liability of the firm. A firm can legally terminate the plan anytime. Upon termination, the firm owes workers pension payments calculated at the termination date. But since these payments are fixed in nominal dollars but are payable many years in the future (usually when workers turn age 65), the real value of these benefits are seriously eroded. If workers expect the firm to terminate anytime, they expect nominal benefits, not real benefits, and hence are not disappointed if the firm terminates the plan.

The problem arises if workers do not anticipate termination. Suppose that workers expect the firm to keep the plan intact and pay an indexed pension, regardless of the firm's legal right to terminate. If workers have an implicit contract with the firm that an indexed pension will be paid except and unless unusual market exigencies arise, they perceive a pension wealth far greater than suggested by a calculation of legal liabilities. They expect real pension benefits. But if termination occurs, they receive nominal benefits. The difference between nominal and real pension benefits is very large.

Pension promises are made by the firm in return for explicit consideration by workers. Pensions are not provided gratis; firms must pay competitive compensation packages. If pensions are provided, they must be given in lieu of some portion of cash wage. When workers implicitly forgo some portion of their wage in exchange for the promise of receiving a pension benefit some time in the future, the firm in effect assumes a liability in the amount of the foregone wage. The sum of foregone wages plus interest is the worker's pension wealth. It is also the amount the firm implicitly promises to return to workers in the form of pension benefits. The firm's liability is the worker's pension wealth: there is a one-to-one equivalence.

The question is, what is the amount of the liability? The level of pension wealth? Is the liability equal to a terminated benefit or a real benefit? Which kind of pension did the worker pay for through foregone wages? If the worker pays for a real pension, his pension wealth (the firm's true liability) greatly exceeds the firm's legal liability, and hence a termination imposes large capital losses on workers. If the worker pays for a nominal pension, termination imposes no losses on workers.

The difference between terminated and real pension benefits can be illustrated with an example. Suppose the announced pension annuity at retirement is indexed to the final wage. Consider a 55 year old worker who expects to retire at age 65 and who has a salary of say $10,000. Suppose real wage growth and the real interest rate are each zero but inflation is ten percent per year. If he expects the pension plan to remain intact then if expected wage growth (through inflation adjustments) is ten percent per year, his expected pension at retirement will be indexed to his retirement wage, $27,183.

If the plan terminates immediately, while ten years from retirement, he will receive a benefit that is proportional to his current salary, $10,000. Suppose that despite the firm's legal right to terminate, workers expect their pension plan to remain intact, enabling them to receive real pensions upon retirement. What implications would an unexpected termination have on their pension wealth?

If workers must pay for their pension — and competitive pressures ensure that they must — then at any given time, workers will have foregone sufficient wages to pay for the present value of the pensions they expect to receive, based on service rendered to date. For the sake of illustration, suppose the probability that our 55-year old worker will leave the firm or die prior to retirement is zero and that it is known with certainty that the firm will survive over the relevant time horizon. Also assume for simplicity that the worker will receive his benefit in the form of a lump sum equal to 10 percent per year of service times final salary.[4/] Finally, assume the worker has 20 years of service at age 55.

[4/] The lump sum simplification does not influence the qualitative results. Similarly, the assumption that benefits are proportional to final salary has no significant implications for the results. Even if the defined benefit plan is expressed as a "flat" benefit, the same arguments hold as long as workers expect the "flat" benefit in effect to be indexed to the wage level.

In this example, if the worker expects to receive an indexed benefit at retirement age 65 (that is, one based on his projected salary of $27,183) then on the basis of his 20 years of service to date, the value of his pension viewed at age 55 is:

(1) Lump sum value of

indexed pension = (10% x 20 years x $27,183) x .367 = $19,952,

where the factor .367 is the present value of $1 to be received ten years from now at age 65, discounted to age 55 using a 10 percent interest rate. The essential economics of the calculation are embedded in the notion that the worker pays for what he gets, and hence in consideration of this expected pension, our 55 year old worker must have foregone the present value equivalent of $19,952 by age 55.

Now suppose the firm unexpectedly terminates the pension plan immediately. In this case, the worker's expected pension at age 65 will be based on service to date and his current salary at age 55 ($10,000). Thus, the present value of this annuity evaluated at age 55 is:

(2) Lump sum value of

legal pension = (10% x 20 years x $10,000) x .367 = $7,340.

Upon termination, the worker's pension wealth is only $7,340.

The bottom line in these calculations is this: if the worker expects a real pension, he will have deposited $19,952 with the firm as of age 55. If the firm suddenly terminates the plan when he is age 55, the present value of his pension is worth only $7,340. The difference between his expected pension $19,952 — which equals wages foregone in anticipation of receiving his pension — and the terminated value $7,340 is a capital loss imposed on workers by the termination.

Significant economic research has been performed to test the hypothesis that workers expect, and hence pay for, real not nominal pensions. Space precludes a detailed review of these results. In a nutshell, however, the results are consistent with the intuitively appealing hypothesis that workers have an implicit contract with the firm that the pension contract is written in real terms, that widespread terminations midstream are not expected. That is, economic research to date supports the notion that terminations surprise, and hence impose substantial capital losses on workers.5/

It is easy to quantify the extent of these losses. In the above example, a nominal interest rate of ten percent resulted in a capital loss equal to approximately 60 percent of real pension wealth. With a zero interest rate, the loss would have been zero. Clearly, the capital loss is related to the inflation rate; in addition, the size of losses varies greatly depending upon

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5/ This line of research has taken two forms. The first approach deals with quit rate data: if workers perceive substantial pension capital losses from voluntarily quitting a pension firm — that is, if they pay in amounts to the pension plan that greatly exceed the nominal benefit they are entitled to collect if they quit the firm early — presumably voluntary quit behavior should be negatively related with the existence of pension plans. If they pay in amounts equal to the nominal benefits they would get if termination occurred immediately, quit rates would be unrelated to pensions. The evidence provides overwhelming support for the former hypothesis. Quit rates are sharply lower in firms that offer pensions. See, for example, Olivia Mitchell, "Fringe Benefits and Labor Mobility," The Journal of Human Resources 17 (Spring 1982), 286-298; or B. McCormick and G. Hughes, "The Influence of Pensions on Job Mobility," Journal of Public Economics 23 (February 1984), 183-206. The second approach formalizes the expectations model outlined above for two cases, one where workers expect real benefits, the other where workers expect nominal benefits; the implications of both hypotheses for wage profiles are derived and tested empirically. Results support the implicit contract theory of pensions. See Richard A. Ippolito, "The Labor Contract and True Economic Pension Liabilities," American Economic Review (December 1985), forthcoming.

the age and service level of workers. Actuaries have already devised schemes to systematically evaluate pension liabilities for all workers in the firm assuming that either real or terminated pension benefits will be paid. The difference between these calculations (expressed as a percent of real expected liabilities) summarizes the economic losses from termination on all workers (and retirees) in the firm. The results of this exercise for various levels of the nominal interest rate are shown in table 1.

The results show that during the period 1950-1965 with moderate levels of the nominal interest rate (incorporating 2-3 percent inflation), worker losses from terminations are less than 25 percent of expected real pensions. But as inflation and the nominal interest rate increase, capital losses increase greatly. In 1982, for example, the long term nominal interest rate was 13.8 percent; worker capital losses from pension plan terminations reached 53 percent; that is, for workers as a whole, a termination in 1982 resulted in a loss of 53 cents of each dollar of pension wealth.

The data in column 1 make it apparent that, from a legal perspective, workers' claims to pension promises upon terminations is an elusive concept. Over time, terminations could have cost workers anywhere from 15 percent of benefits (1950-1955) to 53 percent (1982). Workers' property rights to their pensions are written in nominal terms which means that their true pension claims is a variable concept, driven almost entirely by an exogenously determined parameter, inflation.

The numbers in column 2 of the table are equally interesting. They represent the portion of pension trust assets revocable by the firm upon termination. The revocability portion of assets — the potential reversion upon termination — was essentially zero prior to 1965: when inflation and nominal interest rates are low, legal liabilities tend to approximate real

Table 1

Capital Losses and Excess Assets from Terminations 1950-1983

Year	Termination Losses ÷ Economic Benefits a/ (1)	Legal Excess Assets ÷ Assets (Typical Plan) (2)	Long Term Interest Rate b/ (3)
1950	15%	0%	2.6%
1955	15	0	3.1
1960	25	0	4.4
1965	22	2	4.5
1970	40	21	8.0
1975	41	8	8.8
1978	40	9	9.0
1979	42	17	9.6
1980	51	41	12.0
1981	50	43	14.0
1982	53	44	13.8
1983	42	36	12.0

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a/ Source: Economic (X) and legal (Y) funding ratios are found in Richard A. Ippolito, *Pensions, Economics and Public Policy*, a Pension Research Council monograph. Homewood, Illinois: Richard D. Irwin, 1985, forthcoming, table 4-5. Worker losses as a percent of economic benefits equal $X[(1/X) - (1/Y)]$. Legal excess assets as a percent of assets is $1-(1/Y)$.

b/ Moody's corporate Aaa bond quotations.

liabilities, making it less likely that any portion of trust assets are legal "excess".

While market performance plays a role, generally speaking, as (expected) inflation, and hence long term interest rates increase, legal liabilities fall because of high discounting of nominal benefits: the result is that a larger portion of trust funds become legally revocable. For example, by 1980, fully 41 percent of pension assets could have been reverted to the firm upon a voluntary termination. In 1979 only 9 percent of assets were revocable; in 1965, 2 percent. Again, the data make it apparent that, in real terms, pension trust law defining irrevocable trust assets is fluid, introducing uncertain property rights under different inflationary conditions.

B. Tax Preference Aspects of Reversions

Worker capital losses are not the only transfer embedded in reversions. The U.S. Tax Code affords special status to pensions: workers and firms have the opportunity to provide for retirement by saving in a vehicle that is not subject to the same taxation as other savings programs. If firms legally obtain use of a portion of assets accumulated in a tax exempt trust from a reversion through plan termination, a portion of the reversion would not otherwise exist, had normal tax rules been applied to pension savings. Upon the occurrence of a termination, a portion of the reversion represents pension tax preference. That is, the tax-exempt status awarded pensions is in the effect taken by stockholders because the IRS does not attempt to recoup the tax advantage embedded in the reversion. Approximately 10-20 percent of the reversion is in effect a contribution of the IRS to stockholders who receive reversions from terminations.

1. The Nature of the Tax Advantage

The tax advantage of a pension fund to a corporation is not attributable to the deductibility of contributions. Wages and other corporate expenses are also deductible. Nor does the advantage arise because contributions to a pension fund can be deducted earlier than can "pay-as-you-go" contributions which are deducted at the time that benefits are paid. The advantage of the earlier deduction is exactly offset by a later deduction that must be larger to provide the same benefit.

The essence of the tax advantage is that in contrast to profits generated from an investment in the corporation, earnings of the pension fund are not subject to taxation. As such, the Tax Code encourages individuals and firms to use pension vehicles to save for retirement in an efficient way. To the extent that the intent of public policy is that pension plans, together with their favorable tax status, should be used only for accumulating funds for the purpose of paying pension benefits, the issue arises whether the tax advantage afforded pensions should be forfeited if excess assets in a terminated plan revert to the firm.

The magnitude of the tax advantage afforded to reversions is considerable. Compare the following two situations: one, where a firm invests $100 in profits in the firm (where returns on this investment are subject to corporate taxation); and one in which the $100 in profits are diverted into the pension fund, accumulate at a pre-tax interest rate, and are reverted (via termination) to the firm (subject to the corporate tax rate). For example, suppose the corporate tax rate is 50 percent, the interest rate is 7 percent and a $100 contribution is made in period one; in year 20 the pension plan is terminated, leaving the $100 contribution plus interest as a reversion.

If the firm saves $100 outside the pension plan, it pays $50 in corporate tax immediately, and the $50 remaining accumulates at a 3.5 percent (after-tax) interest rate; in year 20, the firm has $100.70. If the firm instead diverts the $100 to the pension plan, the corporate tax is deferred and the $100 accumulates at the (before-tax) 7 percent interest rate. In year 20, the plan terminates and the firm pays the corporate tax on the full value of the reversion. In this case, the gross-of-tax reversion is $405; after tax, the firm will have $202.50: compare this to $100.70 available in the non-pension savings vehicle. The tax advantage embedded in the gross-of-tax reversion is approximately 25 percent ((202.50 minus 100.70) ÷ 405).

In actuality, a firm will not deposit the present value of the excess accumulation (ultimately the reversion) all at once. If the firm accumulates the excess gradually over the life of the plan,6/ the portion of the reversion that would that otherwise be in the U.S. Treasury if the preferential tax treatment had not been afforded to the reversion portion of plan assets will be somewhat lower. In the above example, the IRS share of

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6/ It is assumed that the pension plan accumulates its excess by making"excess" contributions that grow approximately at the interest rate over a 20-year period. The interest rate is assumed to be 7 percent.

the reversion in the case where the excess was accumulated gradually is 17.5 percent.[7]

2. Magnitude of the IRS Share of Reversion

Table 2 contains the results of a series of these calculations assuming either sudden or gradual accumulation of excess, different periods of accumulation and different nominal interest rates. If the IRS pursued a reversion tax policy designed to deny pension tax advantages to reversions, it would set tax rates in these ranges. It is apparent from the results that if the tax is to be offsetting in a wide range of realistic cases, it must be set relatively high. For example, consider the arguably realistic case that terminated-excesses accumulate gradually over a relatively long time horizon. Even if the nominal interest rate is only five percent, a clear lower bound in light of recent or projected experience, the tax rate would be 13.6 percent if

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[7] If the firm saves the "excess" amount A_0 in period 0 and lets this contribution grow at the rate g then if the interest rate is r, the amount of the reversion in year I is

$$R = A_0 \int_{i=0}^{I} e^{(r+g)i}\, di.$$

In period I, termination occurs and therefore the stockholders receive the amount $(1-t)R$ where t is the corporate tax rate. If the firm saves the pre-tax flow A_0e^{gi}, $i = 0,20$, outside the plan instead, it will be taxed on the investments each period, and the corporate tax rate will be applied to the earnings each period. Thus, the same savings flow yields the after-corporate tax amount in year I equal to

$$R' = (1-t)A_0 \int_{i=0}^{I} e^{(r(1-t)+g)i}\, di.$$

Thus, the after-tax advantage of using the pension plan to save the same flow over time as a percentage of before-tax reversions is:

$$s = (R(1-t) - R')/R.$$

In the case where $i = g = .07$, $I = 20$ years and $t = .5$ then $s = .175$.

Table 2

Portion of Reversion Attributable to Pension Tax Preference

Case I. Reversion Attributable to Sudden Increase in Funding

Interest Rate (nominal)	Number of Years Between Overfunding Event and Reversion			
	5	10	20	30
		(percent x 100)		
.03	3.6	7.0	13.0	18.1
.05	5.8	11.0	19.6	26.3
.08	9.0	16.4	27.5	34.8
.10	11.0	19.6	31.6	38.8

Case II. Reversion Attributable to Gradual Excess Contributions a/

Interest Rate (nominal)	Number of Years Over Which Excess Contributions Occur			
	5	10	20	30
		(percent x 100)		
.03	1.7	3.9	8.0	12.2
.05	3.2	6.7	13.6	20.3
.08	5.3	10.8	21.6	30.3
.10	6.6	13.6	26.3	35.2

a/ The numbers in this portion of the table are based on the assumption that the excess contributions increase over time at a rate equal to the interest rate; similar calculations based on growth rates equal to one-half and double the interest rate generated similar results.

Table 3

Defined Benefit Plan Terminations 1950-1984

	Terminations		
Year (1)	Number of Plans Per Year (2)	Average Plan Size (3)	Percent of Covered Workers Affected Per Year (4)
1950-1954	96	55	.0004
1955-1959	199	55	.0009
1960-1964	336	52	.0009
1965-1969	522	47	.0010
1970-1974	1,706	36	.0020
1975-1979	5,140	23	.0036
1980-1984 a/	5,100	48	.0073

Data in this table include all terminations. It is not known which portion of these events involved excess assets (except those occurring after 1978 — see text).

Source: . Hay Associates, Pre-ERISA Plan Termination Benefit Losses, Report submitted to the U.S. Department of Labor, 1979; and Pension Benefit Guaranty Corporation, Analysis of Single Employer Defined Benefit Plan Terminations, annual.

a/ Actual data for four years 1980-1983 is averaged to project the 1984 experience.

it was made over a twenty-year period. In a more realistic interest rate range, eight percent, the reversion tax rates would be 21.6 percent.

For a range of realistic interest rates, the appropriate reversion tax rate would appear to be at least 10 percent. Offsetting rates in the vicinity of 20 percent would not be unrealistic in light of the figures shown in the table.[8/]

II. POSSIBLE ECONOMIC REASONS FOR VOLUNTARY SUFFICIENT TERMINATIONS

Are terminations for reversion any different from terminations without excesses? Why the sudden concern for terminations just because a reversion is inolved? One reason is contained in the data reported in table 3. While the rate of terminations (with and without "excess" assets) has been a persistent phenomenon in the pension industry, it has been increasing with time. In the period 1965-1969, only one defined plan participant in 1000 was affected by a termination in a given year; during the period 1980-1984, 7.3 participants per 1000 were affected each year.

A second explanation is given by the data shown in table 1. As a general rule, "excesses" in the pension plan tend to increase when worker losses from terminations also increase: inflation works to increase losses and excesses

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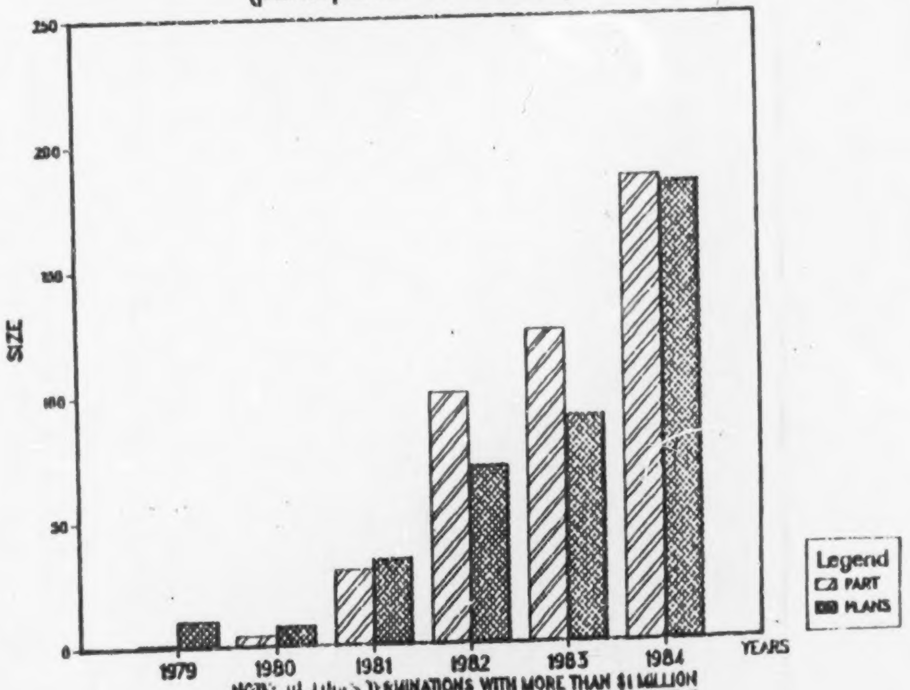
[8/] A schedule of reversion tax rates would not be unworkable. For example, suppose a conservative approach is adopted; that is, it is assumed that the amount of a reversion was accumulated over a lengthy period (bottom portion of table). The presumption could be made that the "excess" accumulation took place either over a twenty-year period or the life of the plan, whichever was shorter. At the beginning of each tax year, the "average" interest rate prevailing over the past twenty years (and all shorter periods for younger terminating plans) could be calculated. All plans terminating in the forthcoming plan year would be assessed the corresponding tax rate. The tax would not affect the normal corporate tax assessment on the reversion.

in unison. Thus, even if the rate of terminations is independent of the reversion potential, capital losses to workers from terminations has been decidely increasing with the reversion potential: in this sense, reversion potential is a short-hand reference to large capital losses for workers. Not only are losses imposed by terminations, but in the case of reversions, assets deposited in the fund might reasonably be presumed to manifest the credibility of the pension promise: yet, these assets are used for other corporate purposes.

A third explanation is found in the suspicion that the existence of the potential reversion is itself causing an increase in the rate of terminations. Data on large reversions ($1 million or more) has been maintained only since 1979. Prior to this, it is not known which portion of terminations involved excess assets. The data reported in figure 1 shows that over the period 1979-1984, the popularity of reversions has increased at an exponential rate; reversions in these terminations has reached $6 billion (current dollars), half in 1984 alone.9/ Some growth is attributable to the appearance of large legal excesses over this period (see table 1); that is, a constant rate of terminations would automatically produce more reversions during the period just because legal "excess" assets are historically high. But data is presented below suggesting that the rate of terminations itself is correlated with the appearance of potential reversions, suggesting that the redefinition of revocable assets itself causes more terminations.

9/ This data is available from the Pension Benefit Guaranty Corporation (PBGC) (unpublished). Pending terminations are allocated to years of actual termination using unpublished PBGC data.

FIGURE 1
TERMINATED DEFINED BENEFIT PLANS: 1979–1984
(participants in thousands)



NOTE: INCLUDES TERMINATIONS WITH MORE THAN $1 MILLION IN ASSETS REVERTING TO THE PLAN SPONSOR AND THE NUMBER OF PARTICIPANTS COVERED BY THESE PLANS
(1984 Data Projected)

In this section, the possible economic rationale that underlie the termination and reversion phenomena are discussed. In the next section, available empirical evidence is brought to bear on these issues.

1. Reflection of Trend Towards
Defined Contribution Plans

Perhaps the most apparent candidate to explain the growing number of voluntary terminations including those awarding reversions, is the trend in the overall private pension plan universe towards defined contribution plans. In table 4, data is presented showing the relative share of private pension assets held by defined contribution plans over the period 1950-1980. The trend in favor of defined contribution plans has been persistent. In 1950, defined contribution plans held 11.6 percent of private plan assets; in 1980 they accounted for 27.8 percent.

Most of the growth in defined contribution plans is attributable to the creation of secondary plans covering workers already participating in "primary" defined benefit plans (column 2, table 4). In recent years, however, defined contribution plans also have become more prevalent as primary plans. In 1980, fully 18 percent of private pension plan participants were covered solely or primarily by defined contribution plans; in 1970, only 12 percent of participants had such coverage (column 1, table 4).

Viewed in this context, a portion of the trend in voluntary terminations of defined benefit plans in favor of defined contribution plans could reflect this overall trend, albeit in a more dramatic way. Table 5 shows that 71 percent of all participants in voluntary terminated sufficient plans for which data are available are offered new plans; 60 percent of the participants were given a defined contribution plan.

Table 4

Defined Contribution Plan Coverage, 1950-1980

Year	Participants With DC-Plan Primary Coverage (1)	DB-Plan Participants With DC-Plan Secondary Coverage (2)	DC-Plan Share of Pension Plan Assets (3)
	(percent X 100)		
1950	18.6	5.7	11.6
1955	12.0	12.6	14.7
1960	12.2	20.6	18.0
1965	12.9	20.9	20.8
1975	14.6	23.7	25.7
1980	18.0	33.0	27.8

Source: Ippolito, supra, notes to table 1. Numbers in columns 1 and 2 are estimates based on observations available for years in the vicinity of the years cited.

Table 5

Terminated Sufficient Plans by Type of Successor Plan

Type of New Plan Adopted		Plans		Participants
		(percent x 100)		
New Plan Adopted		45		47
Defined Benefit	1		1	
Profit Sharing	17		18	
Defined Contribution	6		10	
Type Unknown	21		18	
No New Plan		25		20
Unknown if New Plan Adopted		30		33
Total		100		100

Source: Pension Benefit Guaranty Corporation Case Processing Tape.

Data are based on terminations occurring from 1979 through mid 1983. Responses reflect firms' intentions to start new plans; it is not known if new plan patterns actually reflect these intentions.

If new plans are sufficiently generous, and if firms devote the reversions to offset worker losses from termination, few implications may remain, except perhaps one that addressed the issue why the trend in private pension plans is towards defined contribution varieties. The data required to fully consider this issue, however, is neither readily available nor easily obtainable. The generosity of a newly-created second plan (or the increased generosity of an existing second plan) must be determined, and compared to losses realized by workers owing to the termination of the pre-existing defined benefit plan. These calculations require more detail about the parameters of the new and old plans than is currently available.

2. Optimal Borrowing From the Pension Plan

Termination is the only legal means the firm has to borrow from its pension fund. In this scenario, the firm is portrayed as healthy and fully intending to pay the real value of promised pension benefits. Prior to ERISA, the firm may have explicitly borrowed monies from the pension. But since ERISA, such borrowing (beyond ten percent of the plan's assets), is illegal. Hence, under some conditions, the firm will terminate the pension plan to acquire the "loan" through the reversion. Presumably, the loan would be "paid back" to workers through contributions to a new plan.

This argument implicitly assumes that it is optimal for the pension plan sponsor to loan itself monies at a below-market interest rate. If a market interest rate were charged, why would the firm need to use the pension plan? Why not use the market? If a below-market interest rate were charged, how does the firm gain? If it intends to pay its real pension promises, it is required ultimately to contribute the difference between the market interest rate which the plan could have earned and the below-market interest rate which the plan did in fact earn.

Beyond this, the pension plan represents a tax-exempt accumulation vehicle. It is hard to imagine that the firm could earn an after-tax rate of return outside the pension plan that exceeded the pre-tax rate of return inside the fund.

Notwithstanding this logic, some data reported below is consistent with the borrowing hypothesis. Certainly, this argument is specific to terminations for reversion: if reversions are not available, firms would not have an incentive to terminate the plan. In addition, if this were the motivation for some terminations, we would expect the firm to attempt to reduce the capital losses imposed on workers by terminations.

A variant of this argument is that through unanticipated increases in asset values, the firm finds its plan to be overfunded not just in termination sense, but in an ongoing sense. The plan holds enough assets to pay all of its contracted projected liabilities, yet it cannot gain access to assets that exceed this amount. The only way to obtain access immediately is to terminate the plan, perhaps beginning a new one that awards past service credit. But again, even if the plan is overfunded in an ongoing sense, this is precisely what the plan sponsor should want to do to maximize the tax gain to the firm of the pension tax-exempt status.

3. Tax Abuse

The potential tax gain from overpromising pension benefits is another issue to consider. The nature and magnitude of these tax gains was considered above. Essentially, because tax law permits corporations to save in the pension plan tax-free, firms have powerful incentives to set-up "over-generous" pension plans with the intent of taking reversions (which embody up to 35 percent of IRS money - see table 2).

It is entirely plausible that some (especially small) firms may set-up pension plans with the intention of terminating them. Workers may well not expect real pensions to materialize in such firms and therefore presumably would neither accept a significantly lower wage in exchange for the pension nor be surprised when the pension was terminated. The only loser in such a would be the U.S. Treasury which foregos tax revenue it otherwise would have collected, tax revenue which comprises a portion of the reversion. While it is difficult to test this notion, certainly it is easy to devise a tax policy that discourages this type of activity: the Tax Code need only be modified to recoup the tax advantages afforded to the reversion portion of plan assets (see below).

4. Violation of an Implicit Labor Contract

Voluntary terminations could in some cases represent attempts by firms to mislead workers. Certainly, if firms announce a pension and if workers anticipate that the plan will be kept intact, they will presumably accept lower wages in exchange for the promised pension (see above). If so, the firm can make a once-and-for-all gain at the expense of workers by terminating the plan midstream. In this case, the firm benefits from lower wages commensurate with workers' expectations of receiving real benefits but, in fact, pays only nominal (termination-based) benefits. This interpretation of voluntary terminations apparently underlies some of the public policy concern with terminations and accounts for at least some proposals to award reversions to workers.10/

While such terminations may take place, it is also true that the termination identifies the firm as dishonest in the labor market. Workers would presumably be reluctant to invest significant portions of their worklives in a firm that has demonstrated a propensity to cheat its workers in the past. While this potential cost may well outweigh the short term gain affiliated with a reversion, it nevertheless remains a plausible hypothesis that voluntary terminations merely reflect a unilateral reduction in promised compensation. This may be especially true when terminations occur in the context of a merger, sale or acquisition. If acquired firms terminate their plan and enroll employees into the acquiring firm's pension plan, it is not clear how the market enforces the reputation contract once the acquired firm in some sense disappears from the market.

This theory is independent of the reversion phenomenon. The gain to the firm is equal to the difference between the economic liability and the legal liability: the actual amount of assets in the plan is irrelevant. But the

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10/ For a review of issues and the underlying policy concern about reversions, see U.S. Senate Committee on Labor and Human Resources, Subcommittee on Labor, Hearings on Moratorium on Pension Plan Reversions, 98th Congress (2nd gain to Session), April 4, 1984. A bill proposing that reversions belong to workers (except in cases of "business necessity") is found in H.R. 6404 ("Plan Termination and Reversion Control Act of 1984") submitted in the 98th Congress (2nd Session).

the firm in this scenario will tend to be highest when legal excesses in the plan are also large (see table 1).

5. Financially Troubled Firms:
Renegotiating a Wage Contract

The final theory considered here is one that views voluntary (sufficient) terminations in the same way as terminations from failed firms. That is to say, it is plausible that for each one hundred firms that encounter financial problems sufficient to threaten firm failure, fifty may actually fail (creating terminations from failed firms); the remaining fifty may restructure the firm to attempt their salvation. If high compensation costs are part of the cause for the firm's competitive difficulties or if workers as a group decide to participate in the firm's revival (perhaps because their opportunity wage is low), terminations from ongoing firms may reflect an implicit contract between workers and the firm: workers reduce their level of compensation and, in return, the firm commits itself to continued investment in the firm. Workers may either accept this salary reduction permanently or accept, say, a profit sharing plan in exchange which could lead to a recoupment of their losses, should the firm perform unusually well in the future.

Several observations are consistent with this notion. First, it is consistent with wage concessions recently observed in low-growth, often unionized industries; terminations of pension plans may be another version of these concessions. Second, a significant portion of plans created after termination are profit-sharing plans (table 5), suggesting that future pension benefits are tied directly to firm performance.

III. AVAILABLE EMPIRICAL EVIDENCE

Despite puzzles posed by terminations to labor economists — why are long term pension contracts being broken? — and financial economists — why are plans defunding their tax advantageous pension plans? — very little empirical work has been done to analyze the phenomenon. In this section, available evidence from several sources are brought together in an attempt to bring some evidence to bear on the propositions discussed above.

It is important to put the reversion phenomenon in proper perspective. In table 6, estimates of assets in defined benefit plans that are potential reversions upon termination are given. If all defined benefit plans terminated in 1984, $348 billion in legal excess assets could have been taken by shareholders (see column 3). In fact, only .9 of one percent of revocable assets was taken by firms; and this was by far the largest portion of revocable assets taken in any year between 1979 and 1984.

The data show that the study of terminations for reversion is a study of aberations in what otherwise is a stable pension market. That the vast majority of revertible assets are not taken by firms — even though they legally could be — is a testament to strength of the implicit pension contract. But we are still left with the question why a small minority of firms terminate their pension plans for reversions.

A. Time Series Data

As a first step, time series aggregate termination data is considered. The vast majority of these data are comprised of voluntary sufficient terminations. The data, collected by the Internal Revenue Service and the Pension Benefit Guaranty Corporation can be expressed in terms of the portion of the pension-covered workforce affected by a termination during each year starting in 1950 (table 3). Is the rate of termination simply a trend

Table 6

Portion of Revocible Assets Actually Taken Through Terminations

Year	Assets in Defined Benefit Plans a/ (billions) (1)	Portion of Assets Revocible Upon Termination b/ (2)	Revocible Assets (2) x (1) (3)	Actual c/ Reversions (billions) (4)	Portion Revocible Taken As Reversions (4) ÷ (3) (5)
1979	$ 323	.21	$ 67	.002	.000028
1980	390	.70	273	.002	.000006
1981	439	.76	333	.156	.000468
1982	505	.79	399	.397	.000995
1983	571	.56 d/	320	1.587	.004968
1984	622	.56 d/	348	3.153	.009061

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a/ Data are available from annual 5500 pension plan reports, the U.S. Department of Labor. (numbers from 1983 and 1984 are estimates). The data exclude Taft-Hartley (multiemployer) plans because assets in these plans are irrevocable.

b/ Average (weighted) legal funding ratio for all defined benefit plans minus unity. (Source: see notes to table 1.)

c/ Unpublished data, Pension Benefit Guaranty Corporation.

d/ Estimates for 1983 and 1984 are based on data found in Greenwich Research Associates, Large Corporate Pension Plans. Greenwich, Connecticut, 1984.

phenomenon? Is it related to the size of worker capital losses? To the availability of excess assets? Is it driven by ERISA? Is it a natural consequence of the growing maturity of the pension system? Does it reflect a growing pension burden relative to firm equity? The results of the time series analysis are presented in table 7.

The maturity of the pension system is measured by the pension coverage rate. Firms that created pensions early presumably attached high value to pensions; marginal firms that created pensions later presumably attached lower net benefits to pensions, and hence were more likely to terminate, given the occurrence of shocks. Moreover, since pensions mature over a very long period (it takes as long as 50 years to attain full equilibrium), it may take considerable time for firms to appreciate the full implications of the plan, and for firms to make mid-course corrections (sometimes in the form of terminations, presumably replaced by other plans); this tendency generally will be correlated with the growing maturity of the system.

These terminations will be exacerbated when exogenous forces substantially increase the pension burden relative to equity value. This burden is measured by pension liabilities per covered worker in the United States relative to the (deflated) New York Stock Exchange stock index (interacted with the coverage rate).

The estimated coefficients on these variables are positive and highly significant, suggesting that much of the growth in termination plans can be explained by underlying economic forces. Indeed, accounting for the selectivity and pension burden factors, the trend coefficient itself is insignificantly different from zero. Short term effects surrounding the enactment of ERISA, however, are evinced by the data.

Table 7

Determinants of Pension Plan Terminations, 1950-1983

Independent Variable	Coefficient	t-value
Intercept	-10.53	12.4
Time	.0003	.01
Coverage Rate a/	8.73	3.04
Pension Burden b/	.15	3.57
Worker Capital Loss (%) c/	-3.44	2.15
Legal Excess Assets (%) c/	3.75	4.13
ERISA d/	.35	2.20
R-squared	.94	
Durbin-Watson Statistic	2.01	

The equation reflects a logistic specification. That is, the dependent variable is Log of: the percent of pension-covered workforce affected by a termination say T divided by 1-T. Data source: see notes to table 3.

a/ Denotes the percent of the full time, non-agricultural private workforce in the United States covered by a pension plan.

b/ Pension burden is equal to pension liabilities per pension-covered worker relative to the (deflated) NYSE stock index, interacted with the coverage rate. These data and underlying sources are found in Ippolito, supra, notes to table 1.

c/ Denote legal and economic liabilities by L and E and pension assets by A. Worker losses (as a percent of E) are defined as (E-L)/E; legal excess (as a percent of A) is defined by (L/A)-1.

d/ ERISA is a dummy variable equal to unity for the years 1974, 1975 and 1976, zero otherwise. ERISA is widely believed to have caused a one-time spurt in terminations around the time of its enactment, 1974.

That is to say, the coefficient on ERISA (a zero-one dummy variable equal to unity for the years 1974-1976) confirms the widely held belief that ERISA caused a spurt of terminations around the date of its enactment, though the effects are small. Working through the mathematics of the underlying (logistic) model, it turns out that ERISA resulted in terminations covering one-fifth of one percent of the workforce covered by defined benefit plans.[11] We now turn our attention to the variables of greatest interest to the present study.

The results suggest an influence of excess assets on the rate of terminations: the positive coefficient on legal excess assets suggests that the rate of terminations increases during years marked by high potential reversions. In comparison to the mean value of the termination rate or the trend coefficient, the coefficient on the excess assets variable is large, suggesting that the rapid increase in the value of these variables during the 1970s and early 1980s could be responsible for a significant portion of the historically high termination rate (see table 3).

For example, from 1970 to 1980 excess assets increased from 20 to 40 percent of plan assets (see table 1). The results in table 7 suggest that this increase caused the termination rate to increase by .0013; this is sizeable when compared to the mean termination rate over the period (.0023) or the termination rate in 1980 (.0036).

In contrast, the results show no positive impact of worker capital losses on the termination rate. In fact, the coefficient on worker capital losses is significantly negative, suggesting that, other things constant, the termination rate has fallen during periods of high potential worker losses. This is the first bit of evidence suggesting that terminations may not be driven by schemes designed to take advantage of workers, that they are not occurring as a result of exogenous changes in the legal nature of the contract. To the contrary, the result suggests that firms may be reluctant to terminate their plans when large worker capital losses may result. This could portend an increasing rates of terminations in the future, given new devices available to terminate plans without reducing workers' real pension benefits (see below).

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[11] The point estimate in a logit equation is T(1-T)b where T is the value of the dependent variable and b is the relevant coefficient. To calculate the ERISA effect, the value of T in 1973 was used.

In short, the time series data does nothing to contradict the notion that legal excesses may attract more terminations, a result consistent with the notion that terminations for reversions have capital market implications (some firms find it optimal to borrow from the pension plan). But the data are not consistent with the notion that terminations are designed to effect the breaking of an implicit contract, awarding large transfers from workers to stockholders.

B. Cross Section Evidence

Data is also available to evaluate termination experience on a cross section basis. Voluntary (sufficient) terminations are reported on the Pension Benefit Guaranty Corporation Case Processing tape. These data were matched to the 1978 5500 annual pension report tape. A total of 436 such matches were made but only 235 had sufficient data to calculate funding status; over 1900 plans that did not terminate were also on the tape. The data were used to predict the probability of plan termination (in this case, during the period 1979 through mid 1983) as a function of plan and industry characteristics. The results of ordinary least squares regression are reported in table 8. The results remained virtually identical when estimated using a logistic estimation.

The results show how the probability of voluntary termination (which occurred in 10.9 percent of the plans in the sample[12/]) is systematically related to industry and plan characteristics. The numbers in parenthesis are t-statistics.

In a cross section, unless there is data describing the particular age and service characteristics of workers, there is no measurable variation in worker losses from termination. Nevertheless some evidence bears on the implicit contract notion. The most important and most statistically significant result is that union status is negatively correlated with voluntary terminations. The overall probability of voluntary termination in the sample is 10.9 percent. For union plans, the probability decreases by approximately two-thirds. Thus, the data are inconsistent with the notion that terminations reflect another form of union give-backs.

The significance of this result is that union plans — because they are protected by a two-party contract — cannot be terminated without negotiation. If it were in the interest of workers and firms to occasionally terminate pension plans, why would union plans virtually never agree to terminations? Union firms are surely not correlated with financially secure firms.[13/] And if rates of return outside the plan are advantageous to the firm, why cannot unions and firms agree to a termination and subsequent reinvestment of the reversion at the higher rate of return, sharing the gain?

[12/] The sample is deliberately stratified to include more than a proportional representation of voluntary terminations.

[13/] See Richard A. Ippolito, "The Economic Function of Underfunded Pension Plans," Journal of Law and Economics (October 1985), forthcoming.

Table 8

Probability of Voluntary Plan Terminations[a/]

Independent Variables	Coefficients	
Intercept	1.51 (3.96)	.132 (1.27)
Date Plan Created	.0002 (.25)	.0001 (1.27)
Number of Participants (000,000)	-.35 (1.64)	-.37 (1.65)
Union	-.067 (4.62)	-.071 (4.49)
Industry Growth 1958-1972	-.030 (2.31)	-.040 (2.69)
Industry Growth 1972-1981	.254 (.80)	.08 (1.76)
Reversion [b/]	.050 (3.51)	-.0001 (.01)
Size of Reversion [c/]		.058 (2.42)
Industry Worker Characteristics		
Wage		.0086 (2.50)
Age		-.009 (2.75)
% No H.S. [d/]		.41 (1.60)
% Some H.S.		.34 (1.83)
% Some College		.33 (1.24)
% College Graduates		.10 (1.13)

Table 8 (Continued)

Observations	2157	1989
Number of Terminations	235	235
Termination Probability in Sample	.109	.116

Data merges the 1978 5500 Annual Pension Plan Report with the Pension Benefit Guaranty Case Processing Files for the years 1979-1983.

Dependent variable: Zero if no termination; unity if termination occurs.

Numbers in parenthesis are t-statistics.

a/ The regressions reported in this table were run using ordinary least squares; the results remained virtually the same when estimated by a logit model.

b/ Reversion is a dummy variable equal to unity if a potential reversion exists, zero otherwise.

c/ Legal funding ratio for plans that have a potential reversion, zero otherwise.

d/ H.S. denotes high school. The omitted variable is percent completed high school but no higher education.

This result suggests that if occasional terminations are optimal for the firm and workers, the underlying conditions making it jointly optimal are seldom present when the second party must signify its agreement by its signature.

The results relating the probability of voluntary sufficient termination to industry growth are mixed. Firms in industries characterized by low growth during the period 1958-1972 are more likely to voluntarily terminate their plans than firms in high-growth industries. But terminations are unrelated to industry growth during the presumably more relevent period 1972-1981. These results provide weak perhaps contradictory evidence that voluntary terminations are related to firm performance.

The regression also included a variable denoting plans that could receive a positive reversion upon termination.[14/] Presumably, if access to the reversion lay behind the motivation to terminate the plan, the probability of termination should be positively related to reversion status. The results in the table show that the coefficient on reversion status is indeed positive and significant. Other things constant, relatively well-funded plans have a higher probability of being voluntarily terminated. Like the time series evidence, the cross section evidence is consistent with the notion that firms want access to pension fund assets.

An additional regression was run to further test the notion that terminations could represent firms in some sense taking advantage of workers because of exogenous change in the definition of legal benefits. If this

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[14/] In 1978, the average funding ratio on an ongoing basis was 60 percent. On a termination basis, the average ongoing funding ratio was approximately 100 percent. In subsequent years, funding ratios increased because of increases in stockmarket values, making more plans eligible for reversions. To accommodate this trend, the regressions were run assuming that positive reversions would be available during the 1978-1983 period for all plans at least 40 percent funded in 1978.

motivation pervaded terminations, terminations would be observed in instances where the workforce might be less likely to understand the full capital loss ramifications of terminations in periods of high expected inflation. One way of testing this notion is to include wage and educational levels (at the 3-digit industry level) as independent variables in the analysis.

Age level was also included to determine if terminations were occurring in older more established industries where service credits are likely to be high; or newer industries with lower average ages of workers and hence lower credit levels. Finally, a continuous funding variable was included for firms that exhibited potential reversions: do higher funded plans in this group exhibit continuously higher probabilities of termination? The results of this regression are reported in the second column of the table.

The addition of the new variables do not affect the magnitudes and significance of the original variables in the first regression except that the growth rate influence for the 1972-1981 period becomes significantly positive, directly contradicting the growth influence for the period 1958-1972. The reversion dummy variable becomes insignificant, but the coefficient on the continuous funding measure for plans with potential reversions is significantly positive suggesting that the larger the proportion of assets available for reversion, the higher the probability of termination. That is, the impact of reversion potential on the probability of termination is proportional to the size of the potential reversion.

The estimates on the new variables are encouraging to those who belive terminations are not means of "duping" workers. There is no evidence that the educational distribution of workers has any effect on the probability of termination. Moreover, terminations tend to be higher in higher wage industries. In short, the notion that low wage, poorly educated workers are being "targeted" for termination is not borne out by the data. Further, it is interesting to note that terminations are occurring with more frequency in industries characterized by younger workforces. Other things constant, this finding suggests that terminations are occurring where service credits, and hence capital losses, are lower on average than plans that do not terminate.

C. Terminations With Large Reversions

Some additional evidence is available summarizing 59 terminations (for at least $1 million reversions) which were pending at the Pension Benefit Guaranty Corporation in early 1984. These terminations involved $877 million in potential reversions. The data offers a closer look at the nature of these terminations, separating them into particular "types", and also arraying them by the self-reported reason for termination. The results are reported in table 9. The top part of the table distributes the plans (in percentage terms) amongst these categories; the bottom part distributes the reversion amounts (in percentage terms).

The data show that over 40 percent of the plans accounting for fully 82 percent of the reversion total occurred in either so-called spinoffs or so-called reestablishments. Spinoffs occur when the firm splits the pension plan in two, one for active workers and one for retirees. The firm then switches all the legal excess assets into the retiree-participant plan and terminates only this plan, purchasing annuities for all the then current retirees. This could, but does not necessarily mean that retirees will no longer receive inflation adjustments.

Many firms award inflation adjustments either directly from firm profits or through welfare plans set-up specifically for this practice. To the extent that firms continue indexing these retirees benefits, these types of terminations could be explained entirely by a loan theory. Certainly active

Table 9

Pending Terminations Involving $1 Million Reversions, 1984

Type of Termination	Distribution by type:		Reported Reason for Termination a/				
			Firm Failure	Merger	Superceding Plan	Other	Total
	Plans	% (x 100)	% Plans (x 100)				
Spinoff b/	16	27.1	12.5	18.7	37.5	31.3	100.0
Replaced With New Defined Benefit Plan c/	8	13.5	0	25.0	37.5	37.5	100.0
Replaced With New Defined Contribution Plan	17	28.8	11.7	29.4	29.4	29.4	100.0
No Reported Replacement	18	30.6	38.8	38.8 d/	0	22.4	100.0
Total	59	100					
	Distribution by type: Reversions (Millions)	% (x 100)	% Reversions (x 100)				
Spinoff	$506	61.2	9.0	15.5	19.9	55.6	100.0
Replaced With New Defined Benefit Plan	201	21.0	0	6.4	92.5	1.0	100.0
Replaced With New Defined Contribution Plan	116	12.2	57.7	10.7	18.1	13.4	100.0
No Reported Replacement	54	5.6	28.3	54.7 d/	0	17.0	100.0
Total	$877	100					

Table 9 (Continued)

a/ Firms were asked to respond to a question why they terminated the plan. "Firm failure" includes responses indicating a liquidation or bankruptcy, plant closing or adverse business conditions. "Merger" includes responses indicating sales of company and mergers per se. "Superceding plan" simply means that the firm indicated it wanted to establish a new plan; no further reasons are given.

b/ A "spinoff" occurs when a plan sponsor splits the defined benefit plan in two, one for current workers and one for current retirees; puts all "excess" assets in the retiree plan then terminates the retiree plan.

c/ In these cases, the firm terminates the plan, takes the reversion, then restarts a similar plan, often giving past service credit.

d/ Some of the plans reported in this cell may have been replaced by a plan already existing in the acquiring firm.

workers are unaffected except infsofar that a now-lower funding ratio could increase the probability that the firm will ultimately terminate the plan (unless they expect a further spinoff after they retire). The spinoff could equally represent a one-time theft-of-sorts from workers already retired from the firm.

In the case of defined benefit replacement terminations (so-called reestablishments), the old defined benefit plan is terminated, replaced with a new similar defined benefit plan. Retirees are in the same position as a spinoff. Active workers are unaffected if the new defined benefit plan offers past service credit with integration with the old plan. The only difference is that the firm has in effect reduced the funding level in the plan to the legal ratio. These reestablishment cases — to the extent past service credit is granted — are consistent with the loan theory described above. It is known that some reestablishment cases offer past service credits but credible data is not yet available for the population of reestablishment cases.15/

The vast majority of the reversion amounts in the spinoff and reestablishment cases are neither affiliated with firm failure nor mergers; that is, presumably mergers can also signal a firm profitability problem if the merger is occurring because the target firm is being run inefficiently.

15/ When past service credit is offered in the reestablished plan, it means that even though the old plan freezes benefits in nominal terms, the new plan includes past service years thereby insuring continued indexing of benefits. To prevent double payment for past service, the new plan must be integrated with the old plan or past service credits must be tied to a lower level of generosity. Based on a small sample of reestablishment cases, the Pension Benefit Guaranty Corporation reported that most reestablished defined benefit plans offered past service credit. See U.S. Senate Committee on Labor and Human Resources, Subcommittee on Labor, Hearings on Moratorium on Pension Plan Reversions, 98th Congress (2nd Session), April 4, 1984; page 40.

In short, the efforts in these cases to offset worker losses and the lack of evidence suggesting firm profitability problems suggest that there is some market for firms borrowing from their pension funds. The borrowing scenario is the only plausible explanation for these types of terminations for reversions.

The remaining 60 percent of terminations reported in the table (representing less than 20 percent of the reversion amounts) are either replaced with a defined contribution plan or no plan. And indeed there is a decided shift in the reasons for termination in these cases. Fully 50 percent of the reversions affiliated with a new defined contribution plan or no new plan appear to be in firms with failure problems. Only 15 percent of the reversion amounts in the spinoff or reestablishment cases are affiliated with these events. These data give some support to the firm failure/firm profitability theory.

On balance, the weighted data, at least involving large terminations for reversions, are consitent with the notion that firms try to keep at least active workers insulated from capital losses in the majority of cases (weighted by reversions), suggesting again that the loan theory — despite its variance with theoretical arguments — could be responsible for much of the termination for reversion phenomenon.

IV. PUBLIC POLICY IMPLICATIONS

Several features of voluntary terminations with reversions provide the core for public policy concern. First, unless otherwise offset by higher wages or new plans, terminations appear to be costly to workers, representing reductions in (presumably) expected real pensions that could easily be in the vicinity of 50 percent. Second, even if firms take steps to offset worker losses, funding levels in surviving plans will be reduced to the legal limit, creating more risk for workers that the plan may not be economic in the long run. Third, the size of reversions to the firm are partly attributable to favorable tax treatment of pension funds. The Treasury's stake in the reversion is likely in the range of 10-20 percent. By not offsetting reversions in the amount of the tax advantage embedded in the reversion, public policy encourages firms to use the pension plan for purposes other than paying pensions.

From a public policy perspective, it is easy to be ambivalent about the implications of the reduction in workers' benefits. If the termination truly represents the firm unilaterally breaking an implicit contract with workers, a case can be made that the reversion belongs to the workers, not the firm. This policy could be effected by making all pension plans irrevocable trusts. The same policy would rule out the firm using the trust for reasons other than paying pensions.

On the other hand, if the termination reflects a wage concession by workers to the firm in exchange for the firm's commitment to continue to reinvest in its capital base, the reversion can be viewed either as a wage concession or (if a profit-sharing plan is created) an investment in the future performance of the firm. There appears to be sufficient evidence to suggest that the potential firm failure notion is a viable explanation for some voluntary terminations accompanying worker losses to warrant further research. More direct information would be obtainable if terminated plans were matched against the plan sponsors' financial performance data.16/

16/ This task involves matching terminations with 5500 annual reports and again matching them to the Compustat data pertaining to the plan sponsors.

Even ignoring the firm failure problem, there are some troubling aspects of pursuing policies that award reversions to workers (or hold firms liable for real liabilities). Though a similar law governs all Taft-Hartley plans[17/] — that is, contributions to these plans are irrevocable — it is hard to support the notion because it would appear that workers and firms could write the pension contract to either make contributions irrevocable (reversions belong to workers), or to reflect a promise to pay real benefits.

Arguably, there are two stumbling blocks to writing either contract. First, there is nothing in the law preventing firms from amending the plan anytime. Thus, even if the firm writes the contract specifically awarding reversions to workers, it can amend the plan just prior to termination to award the reversion to the firm.[18/] Moreover, absent binding language to the contrary, bankruptcy courts will seize the "legal" assets in pension plans regardless of provisions in the plan. A legal mechanism should be instituted to permit parties to pension contracts to bind the plan sponsor (and courts) into fulfilling language in the contract regarding award of reversions to workers.[19/]

Firms not incorporating such language will be required by competitive labor markets to pay risk premiums to workers in the form of higher wages.

[17/] Taft-Hartley plans are otherwise known and multiemployer plans; these plans combine many firms in industries like construction, mining and trucking with usually one prevailing union. The plan is administered by a board, comprised of fifty percent union members and fifty percent firm members.

[18/] This is precisely what happened in the celebrated Washington Star case in 1984.

[19/] This policy could be effected by a congressional amendment to ERISA providing specific language which, if used, could legally bind firms to irrevocable pension plan trusts.

Thus, if the language does not appear, despite its availability, it could be concluded that workers and firms prefer pension plans that give firms flexibility to either impose capital losses on workers (firm failure problems?) or in effect take out large loans against the pension plan.

While many questions surround the public policy reaction to workers' loss of benefits, there would appear to be less uncertainty about the tax implications surrounding reversions. If the U.S. Tax Code has established favorable tax treatment of pension plans to encourage savings for retirement, should the tax advantage awarded to the "excess" savings be retained by the firm when terminations occur? In the case of Individual Retirement Accounts (IRAs), the IRS imposes a ten percent penalty on early withdrawals, implying that the tax preference afforded IRA savings evaporates if the proceeds of the fund are used prior to retirement. A similar policy would attach a claim to that portion of the reversion that would otherwise have accrued to the Treasury, if the "excess" savings took place outside the pension plan.

A rule that denied tax advantages to the reversion portion of a terminated pension plan would erase the incentive for firms to either create pension plans they did not intend on honoring or to use the plan as a contingency savings account. If the Treasury were the only loser from this kind of activity, a case could be made to retain the status quo.20/ But it is inevitable that the creation of pensions that promise real benefits upon retirement will appear legitimate to at least some workers who will in turn make plans assuming that a real pension is forthcoming. A

20/ If these schemes become so widespread that stockholders in effect can save at a tax-free rate to satisfy all their savings motives, the income tax will become a consumption tax. But if this is desired public policy it seems preferable to legislate a consumption tax directly.

straightforward policy to eliminate this problem is to make the pension tax policy clean and unambiguous: pension tax preferences are forfeited unless the savings are used to pay pension benefits.[21/]

Once a reversion tax is established, it is hard to argue that firms should not be allowed to extract legal excess funds from pension plans directly without being forced to terminate. Why firms would want to extract monies from a tax-exempt savings account is inexplicable. But if they want to extract monies in excess of legal liabilities, the policy of requiring firms to engage in significant legal and other transactions costs of terminations just to effect a loan, encourages a waste of resources. In addition, because legal and other transactions cost may be high, it may be "cheaper" for the firm to suffer the consequences of the imposition of worker capital losses than to incur the expenses affiliated with options to offset them. In this sense, requiring terminations to effect loans may inadvertently impose capital losses on workers. If public policy permits loans via terminations, they should allow them directly.[22/]

V. CONCLUDING REMARKS

The prevalence and persistence of defined benefit pension plans in the U.S. is impressive because these plans represent very long term contracts between workers and firms. The contracts are largely built on trust — the

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[21/] A ten percent reversion tax is part of the U.S. Treasury, Tax Simplification Plan, 1984.

[22/] One difference that deserves consideration is that upon termination, the Pension Benefit Guaranty Corporation requires firms to purchase annuities for participants, thereby eliminating any risk to the Corporation. Borrowing from an ongoing plan does not eliminate this risk. As such, a cushion of ten or twenty percent of assets above legal liabilities may be appropriate.

firm can terminate the plan anytime — and hence, their survivability is a testament to the power of the market to enforce implicit contracts over long periods of time. This is why terminations are troublesome. When the contracts are broken in large numbers of cases, even though small in proportional terms, the question begins to be considered whether all workers will begin to discount the pension promise on their firm. In this sense, firms that have no intention of terminating their plans must be concerned about other firms' terminations because their own workers may begin to discount pension promises, even though from the firm's perspective, the benefits are intended to be paid.

Not all terminations involve losses. And those that do may be affiliated with firms that have firm failure/profitability problems. If so, part of the implicit pension contract may involve an agreement to terminate the plan if the firm encounters survival problems. We clearly need more study of the relation between terminations involving worker losses and potential firm failure problems. If losses are found in cases not involving firm problems, we need to study the circumstances that could lead the firm to believe it could escape market response to the breaking of a contract.

When terminations occur that do not involve worker losses (spinoffs, reestablishments with past service credits?), a finance puzzle is raised: why do some firms withdraw funds from a tax-exempt savings account? The data supports the hypothesis that at least in some cases, firms want access to "excess" pension assets. Again, the phenomenon begs for study. Are these loans occurring in financially troubled firms? In firms facing low corporate tax rates, reducing the advantage of saving in the tax-free account?

The whole area of terminations in virgin territory for research. Until more research is done, however, and until more answers are found, the following policy recommendations appear justified:

Recoup tax gains embedded in reversions. To ensure that firms do not use pension plans for reasons other than to pay pension benefits, a tax should be assessed on reversions arising from plan terminations. This makes the termination-for-reversion decision tax-neutral.

Construct mechanisms to permit efficient pension contracting. Under current law, firms cannot bind themselves to award reversions to workers in the pension contract; a legal mechanism should be constructed to make plans irrevocable trusts; except for making this change, refrain from redefining asset ownership in pension plans.

Permit Borrowing of Excess Assets (subject to a reversion tax assessed on monies borrowed). Public policy permits firms to in effect borrow legal excess assets but only if a termination takes place. Forcing firms to terminate to acquire a loan represents a wasteful public policy and may inadvertently lead to increased capital losses for workers. The law already in effect permits firms to borrow perpetually from their pension plan in the sense that funding ratios may be set considerably below 100 percent.[23/]

[23/] Distributions of funding ratios are found in Ippolito, Pensions, Economics and Public Policy, supra. Even in exceptional years, at least half of all pension plans are underfunded.